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# Vol. I

## TRANSCRIPT OF RECORD

## Supreme Court of the United States

**OCTOBER TERM, 1942**

## No. 319

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FIDELITY ASSURANCE ASSOCIATION, A CORPORATION, DEBTOR, AND CENTRAL TRUST COMPANY, TRUSTEE FOR FIDELITY ASSURANCE ASSOCIATION, PETITIONERS,

*vs.*

EDGAR B. SIMS, AUDITOR OF THE STATE OF WEST VIRGINIA, AND EX-OFFICIO INSURANCE COMMISSIONER OF THE STATE OF WEST VIRGINIA, ET AL.

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ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT

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**PETITION FOR CERTIORARI FILED AUGUST 20, 1942.**

**CERTIORARI GRANTED OCTOBER 12, 1942.**

# SUPREME COURT OF THE UNITED STATES

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ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT

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# IN DISTRICT COURT OF THE UNITED STATES FOR THE SOUTHERN DISTRICT OF WEST VIRGINIA

In Proceedings for Corporate Reorganization

No. 4514

In the Matter of FIDELITY ASSURANCE ASSOCIATION, Debtor

ORDER APPROVING DEBTOR'S PETITION—June 6, 1941

This day came Fidelity Assurance Association, by James R. Fleming, its attorney, and presented its verified petition for its reorganization under chapter 10 of the Federal Bankruptcy Act; and it appearing from said petition that the debtor is unable to meet its debts as they mature, and that the debtor desires to effect a reorganization under said corporate reorganization Act, and that it is not a municipal, banking, insurance nor railroad corporation, nor a building and loan association, but is a corporation that could become a bankrupt under section 4 of the Bankruptcy Act, and has its principal assets in this district; and the Judge being satisfied that said petition of said debtor complies with said chapter 10 of the Bankruptcy Act, and has been filed in good faith:

Now, upon motion of James R. Fleming, the attorney for the petitioner, it is ordered, adjudged and decreed that the said petition be and it is hereby approved as properly filed under said chapter 10 of the Bankruptcy Act, and it is hereby determined that said petition has been filed in good faith.

It is further ordered that Central Trust Co., a corporation of Charleston, be and hereby is appointed trustee of and for the debtor and its estate, including all of its property and assets, of whatsoever kind and description and wheresoever situated.

It is further ordered that said trustee give a bond to the United States of America in the sum of $50,000.00 for the faithful performance of its duties as such trustee, and that [fol. 3] upon the qualification of the trustee and the execution and filing of the bond aforesaid with the Clerk of this Court, said trustee shall take all of the property and assets

of said debtor, of whatsoever kind and description and wheresoever situated into his exclusive possession and control, and shall be vested with all the title and rights, subject to the same duties, and shall exercise, subject to the control of the Court and consistently with the provisions of said chapter 10, all the powers of a trustee appointed pursuant to section 44 of the Bankruptcy Act, and such additional rights and powers as a receiver in equity would have if appointed by a Court of the United States for the property of the debtor, and, subject to the authorization and control of this Court, shall carry on, manage, conduct and operate the business of the debtor in its usual course.

It is further ordered that the receivers, H. Isaiah Smith and Ross B. Thomas, heretofore appointed by the Circuit Court of Kanawha County, West Virginia, of the property and assets of said debtor situate in the State of West Virginia, be and hereby are directed and ordered to surrender and deliver to said trustee all of the property, assets and business of the debtor, of whatsoever nature and wheresoever situated, now in their possession and control; and said receivers and their agents and employees are hereby expressly enjoined and restrained from in anywise interfering with the exclusive possession and control of said trustee of said property and assets of said debtor and from selling, assigning, concealing, encumbering, transferring or otherwise disposing of or affecting any of said property and assets.

It is further ordered that each receiver or receivers heretofore appointed by any State Court in the States of Ohio, Indiana, Illinois, Wisconsin, Kentucky, Tennessee, New York and Pennsylvania be and they are hereby directed [fol. 4] to surrender and deliver to said trustee all of the property and assets of the debtor, of whatsoever nature and wheresoever situate, now in their possession and control; and each of said receivers is hereby enjoined and restrained from in anywise interfering with the exclusive possession and control of said trustee of said property and assets of said debtor and from selling, assigning, concealing, encumbering, transferring or otherwise disposing of or affecting any of said property and assets of said trustee.

It is further ordered that all creditors and stockholders of debtor and all other persons, firms, associations and corporations, and all persons claiming or acting by, through,

or under them, including all sheriffs and marshals and other officers, agents, attorneys, solicitors, representatives and employees of them, or any of them, and all receivers of State Courts heretofore or hereafter appointed, or any of them, are hereby enjoined and restrained from instituting, continuing or prosecuting any action at law or suit or proceeding in equity, or any other proceeding, against said debtor or trustee in any court of law or equity or other court or tribunal, or otherwise, and from executing or issuing, or causing, the execution or issuance out of any court, or any public office, of any writ, process, summons, garnishment, attachment, subpoena, replevin, execution or other proceeding for the purpose of examining or taking possession of or interfering with any property constituting the estate of the debtor, or attempting to take into their possession any part of the property constituting such estate, wheresoever situate; and all such persons, firms, associations or corporations are hereby enjoined and restrained from seizing, selling, removing, transferring, disposing of or interfering with, or attempting so to do, any property or assets of said debtor or said trustee, whether or not in their possession or otherwise, and from doing any act [fol. 5] or thing whatsoever to interfere with the possession, management and control by said trustee of debtor's assets, property and effects; and all persons, firms and corporations are hereby enjoined and stayed from commencing or continuing any judicial proceedings in any court to enforce any lien or right of any kind or character upon the estate or property of debtor until further order of this Court.

It is further ordered that said trustee is hereby vested with the power, pending further order of this Court, to conduct, manage, maintain, operate and keep in proper condition and repair all of said assets and property of said debtor, and in connection therewith to employ, discharge and fix the compensation of all agents and employees of the debtor, and to collect and receive all of the income, rents, revenues, issues and profits of said assets and property of said debtor, and to collect all outstanding accounts receivable, and generally to do any act necessary to carry on the business of the debtor, subject to such supervision and control by this Court as by further orders herein it may from time to time exercise.

This court reserves full right and jurisdiction to make from time to time such orders amplifying, extending, or limiting or otherwise modifying this order as to the Court may at anytime seem proper.

Dated this 6th day of June, 1941.

Ben Moore, U. S. D. J.

(The Petition, referred to in the foregoing order, is in the words and figures as follows:)

[fol. 6] IN DISTRICT COURT OF THE UNITED STATES FOR THE SOUTHERN DISTRICT OF WEST VIRGINIA

No. 4514

In Proceedings for Corporate Reorganization

In the Matter of FIDELITY ASSURANCE ASSOCIATION, Debtor

DEBTOR'S PETITION—Filed June 6, 1941

To the Honorable Ben Moore, Judge of the District Court of the United States for the Southern District of West Virginia:

The petitioner, Fidelity Assurance Association, the above named debtor, respectfully states:

I

The debtor, Fidelity Assurance Association, is a corporation duly organized and existing under the laws of the State of West Virginia and has had its principal assets within the above named judicial district for a longer portion of the six months immediately preceding the filing of this petition than in any other judicial district, and that its principal assets of the value of approximately $13,000,000 are now situate in the City of Charleston, West Virginia, in said Southern District of the State of West Virginia, for more than six months immediately preceding the filing of this petition; and that said debtor was incorporated under the laws of the State of West Virginia on the 26th day of April, 1911, as Fidelity Investment Loan Association, and whose name was thereafter changed to Fidelity Investment Association, and on or about December 31, 1940, its name was again changed to Fidelity Assurance Association.

II

The debtor is a corporation as defined in the Federal Bankruptcy Act, which could be adjudged a bankrupt under the said Act, and is not a municipal, insurance or banking corporation or building and loan association, and is not a railroad corporation, authorized to file a petition under the [fol. 7] provisions of said Bankruptcy Act.

III

The debtor for many years was engaged in the business of selling investment or annuity contracts under a license issued by the Insurance Commissioner of the State of West Virginia, pursuant to the statutes of this state; and such contracts were sold by debtor to divers persons in West Virginia and many other states of the United States. That debtor continued actively to engage in this business until on or about the 31st day of December, 1940, at which time it ceased to actively engage in the sale of investment or annuity contracts for the reason that on August 22, 1940, an Act known as the "Investment Company Act of 1940" was enacted by the Congress of the United States and approved by the President, which Act so increased the reserve requirements on the part of debtor to contract holders that debtor found it impossible to comply with the provisions of said Act and ceased the sale of its said securities, and since said 31st day of December, 1940, its only business has been the collection of receipts and payments under said contracts and the disbursement of moneys as required under the provisions of its outstanding contracts.

That on December 31, 1940, debtor amended its charter and changed its name from Fidelity Investment Association to Fidelity Assurance Association, and changed its corporate purposes from those originally authorized to that of the issuance of life insurance policies; that debtor did not and could not comply with the requirements of the West Virginit law in reference to engaging in the life insurance business, and that debtor did not issue or sell any life insurance policies and did not engage in the insurance business; and that the only business in which debtor is now engaged is that of receiving payments on investment or annuity contracts previously sold, as hereinabove set forth, [fol. 8] and that said debtor is not now licensed to sell either insurance or investment or annunity contracts.

IV

Debtor says that its authorized capital stock formerly consisted of 100,000 shares of preferred stock of the par value of $100.00 per share and 30,000 shares of common stock of the par value of $100.00 per share, and that at a stockholders' meeting held on the 24th day of January, 1941, resolutions were adopted seeking to abolish the preferred stock and reducing the par value of all stock from $100.00 per share to $8.00 per share; that the number of shares of preferred stock issued prior to said stockholders' meeting was 9,110 and the number of shares of common stock issued prior to said stockholders' meeting 8,123 shares; that the resolution authorizing a reduction in the par value of said stock, both common and preferred, also called for the exchange of the 9,110 shares of preferred stock outstanding, with a par value of $100.00 per share, for 18,220 shares of preferred stock of the new par value of $8.00 per share and for the exchange of the 8,123 shares of the $100.00 par value common stock outstanding for 8,123 shares of common stock with a new par value of $8.00 per share.

V

The debtor now has in existence and outstanding investment and annuity contracts having a total reserve liability of approximately $25,685,999.79, and it is the owner of assets of the value of approximately $23,000,000, approximately $13,000,000 of which is situate in the City of Charleston, in the Southern District of the State of West Virginia. A schedule containing a full and true statement of all of the assets and liabilities of debtor is filed herewith and is marked "Exhibit A".

VI

Debtor further states that on April 11, 1941, Edgar B. [fol. 9] Sims, Auditor of the State of West Virginia and Ex-Officio Insurance Commissioner of the State of West Virginia, filed his petition in Chancery in the Circuit Court of Kanawha County, West Virginia, asking, among other things, for the appointment of a receiver or receivers for the property and assets of debtor; that on said date the Circuit Court of Kanawha County, West Virginia, in said proceeding appointed H. Isaiah Smith and Ross B. Thomas

as receivers for the assets and property of this debtor; and that H. Isaiah Smith and Ross B. Thomas are now the duly appointed, qualified and acting receivers for all of the property and assets of debtor situate in the State of West Virginia.

That thereafter independent receivers were appointed in the States of Indiana, Ohio, Illinois, Wisconsin, Tennessee, Kentucky and Pennsylvania for assets and property of the debtor situate in those states of the approximate value of $10,000,000; and that said receivers in said states have taken charge of and are now holding the assets of debtor so situate in each of said respective states.

That other receivers may have been appointed in other states, but the above receivers are the only ones that have come to the knowledge of debtor.

VII

Debtor further states that it now has outstanding investment and annuity contracts with reserve liabilities totaling approximately $25,000,000, and that in these contracts debtor agrees to pay interest accumulations of from four to five per cent per annum; that the decrease in interest rates in recent years has made it impossible for debtor to invest its funds in conformance with the West Virginia law and to earn the interest requirements as set forth in its said outstanding contracts; and that by reason of said interest requirements under its said contracts debtor is now suffering an annual loss of approximately $250,000 per annum, [fol. 10] and that this loss will continue and probably increase unless the earnings on sound securities should increase far in excess of the present rate of income.

That for the reasons above set forth debtor has been unable to meet its obligations as they mature and will be unable to meet its obligations as they mature unless the rights of its contract holders are modified so that the earnings received on securities and assets owned by debtor will be sufficient in amount to meet the requirements under its outstanding contracts; and if the rights of its outstanding contract holders are modified to this extent, debtor will be able to meet its reserve requirements and will be able to comply with the Investment Company Act of 1940 and will be enabled to resume the operation of its business.

Debtor further states that each of its existing and outstanding contracts is secured under the terms of each of its

said contracts by a reserve fund, which is on deposit with the Treasurer of the State of West Virginia and with the officials and departments of other states where the securities of debtor were sold; and that the rights of all contract holders must be modified as above set forth in order that debtor may be permitted to obtain adequate relief, and that by reason of these facts debtor cannot obtain adequate relief under chapter 11 of the Bankruptcy Act.

VIII

Debtor further states that no plan of reorganization has been as yet formulated and that it knows of no plan of reorganization, readjustment or liquidation affecting the property of the corporation pending either in connection with or without any judicial proceeding except that receiverships have been created in West Virginia and other states, some of which are threatening to sell the assets now in their possession.

IX

It is the desire of debtor that a plan of reorganization [fol. 11] be effected under the provisions of chapter 10 of he Bankruptcy Act, and that the Court appoint a trustee or trustees to take charge of the assets and property of debtor wheresoever situate and to formulate and present a plan of reorganization for debtor under the provisions of chapter 10 of the Bankruptcy Act.

X

Debtor further states that on the 3rd day of June, 1941, the Board of Directors of debtor met in special meeting pursuant to call and adopted a resolution authorizing the filing of debtor's petition, a copy of said resolution being filed herewith and attached hereto and marked "Exhibit B".

PRAYER

Wherefore your petitioner prays:

1. That an order be entered approving the debtor's petition as properly filed;

2. That the Court immediately appoint a trustee or trustees to take charge of the assets and property of debtor and

with directions to prepare and present to the Court a plan of reorganization under the provisions of chapter 10 of the Bankruptcy Act; and

3. That your petitioner may have such further and other relief as the Court shall deem proper and necessary.

Fidelity Assurance Association. By John Marshall, Jr., Vice President.

James R. Fleming, Attorney for Debtor.

[fol. 12] *Duly sworn to by John Marshall, Jr., jurat omitted in printing.*

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[fol. 13] MEMORANDUM OF CLERK

(Exhibit A (Financial Statements for the year ended October 31, 1940), is being omitted from the record at this point because same is being transmitted in original form in accordance with instructions of Court Order entered March 7, 1942.)

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[fols.14-16] EXHIBIT "B" TO PETITION

Resolution

"Whereas, Receivers have been appointed for the assets of this Corporation, situate in their respective states, by the State Courts of West Virginia, Illinois, Wisconsin, Pennsylvania, Indiana, Kentucky, Tennessee, and Ohio; and that by reason of this fact and the failure of the Receivers in those states to cooperate with the Receivers appointed for the State of West Virginia, it seems impossible to effect a reorganization of the affairs of this Corporation under existing conditions; and

Whereas, it is considered possible and feasible to effect the reorganization of this Corporation by filing a voluntary petition in Federal Court under chapter 10 of the Federal Bankruptcy Act which provides for the reorganization of corporations in situations such as this.

Now Therefore, be it resolved that it is the desire of this Corporation that the Corporation file a voluntary petition for reorganization of its affairs under chapter 10 of the Federal Bankruptcy Act in the proper Federal Court, having jurisdiction of this proceeding and that all necessary

steps be taken under said Act to reorganize the fiscal affairs of this Corporation, and that a plan be effected to reorganize its corporate affairs as provided under said chapter 10 of said Federal Bankruptcy Act.

And Be It Further Resolved that John Marshall, Jr., be directed and fully authorized to file a petition in the proper Federal Court in behalf of this Corporation under chapter 10 of the Federal Bankruptcy Act."

This is to certify that at a special meeting of the Board of Directors of the Fidelity Assurance Association of Wheeling, West Virginia, held at the William Penn Hotel in Pittsburgh, Pennsylvania, on Tuesday, June 3, 1941, in pursuance to notice duly given, the above Resolution was adopted.

(signed) A. L. King, Secretary. (corporate seal.)

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[fol. 17] IN UNITED STATES DISTRICT COURT

[Title omitted]

ORDER AUTHORIZING EMPLOYMENT OF JAMES R. FLEMING AND ALLEN G. MESSICK FOR SPECIAL SERVICES

Comes now Central Trust Company, Trustee herein, and files its petition requesting authority under section 157 of the Federal Bankruptcy Act to employ James R. Fleming, the attorney of record for the debtor herein, and Allen G. Messick, Chairman of the Board of Directors of debtor herein, for special employment, as set forth in said petition, during the period of the administration of the trust.

And the Court having examined said petition and being fully advised in the premises now grants said petition and authorizes said Trustee to employ said James R. Fleming and Allen G. Messick for the performance of such special services as required by said Trustee in the administration of this trust and as set forth in said petition.

Dated this 7th day of June, 1941.

Ben Moore, U. S. D. J.

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(The Petition, referred to in the foregoing order, is in the words and figures as follows:)

[fol. 18] IN UNITED STATES DISTRICT COURT

[Title omitted]

PETITION FOR AUTHORITY TO EMPLOY JAMES R. FLEMING AND ALLEN G. MESSICK FOR SPECIAL SERVICES—Filed June 7, 1941

To The Honorable Ben Moore, Judge Of The District Court Of The United States For The Southern District Of West Virginia:

Comes now Central Trust Company, Trustee herein, and respectfully shows the Court that your Trustee deems it advisable and necessary to employ James R. Fleming, the attorney for the debtor herein, and Allen G. Messick, Chairman of the Board of Directors of said debtor, for the purpose of assisting your Trustee in marshalling the assets of said debtor which are now situate in divers states outside the territorial limits of the State of West Virginia, and also for the purpose of assisting Trustee in the development and formulation of a plan or reorganization for the affairs of debtor in this proceeding, and that your Trustee be also authorized by the Court to employ the above named to perform any other special services other than that of general counsel for the Trustee in the administration of this trust; and that this authority is requested under section 157 of chapter 10 of the Federal Bankruptcy Act.

Wherefore your petitioner prays the Court for an order authorizing this Trustee to employ the said James R. Fleming and Allen G. Messick to perform such special services for this Trustee as hereinabove set forth.

Central Trust Company. By Andrew A. Payne, Executive Vice President and Trust Officer.

[fol. 19] *Duly sworn to by Andrew A. Payne, jurat omitted in printing.*

[fol. 20] IN UNITED STATES DISTRICT COURT

[Title omitted]

ORDER CLARIFYING AUTHORITY AND DUTIES OF TRUSTEE—June 10, 1941

This day came the Central Trust Company, heretofore appointed and qualified to act as Trustee for the debtor in

this cause, and presented to the Court its motion, in writing, moving the Court that the order heretofore entered herein on June 6, 1941, approving the debtor's petition be amended and clarified in that portion thereof pertaining to the delivery of assets of the said Fidelity Assurance Association to the said Trustee.

Upon consideration whereof, and the Court having inspected said written motion, and the said written motion appearing in all respects proper, the same is ordered filed; and it appearing to the Court that good cause is now shown for the amendment of said order, and the Court being of opinion that the said order should be so amended and clarified, it is accordingly adjudged, ordered and decreed that the following named persons and officials, to-wit:

S. Leigh Call, c/o Gillespie, Burke & Gillespie, 508 Reisch Building, Springfield, Illinois.

Charles R. Fisher, c/o State Auditor's Office, Des Moines, Iowa.

Richard T. James, Auditor, State of Indiana, Indianapolis, Indiana.

Hon. Richard McIntyre, Special Attorney, State Corporation Commission, Topeka, Kansas.

John A. Lloyd, Division of Insurance, Columbus, Ohio.

Peter F. Hagan and I. H. Krekstein, c/o Hirschwold, Goff & Rubin, 808-18 North American Building, Broad Street below Chestnut, Philadelphia, Pennsylvania.

[fol. 21] Tom B. Willson and N. J. Lippard, 421 Frick Building, Pittsburgh, Pennsylvania.

Howard L. Smith, c/o Banking Commission, Madison, Wisconsin.

Dewey S. Godfrey, Suite 525, 705 Olive Street, St. Louis, Missouri.

State Securities Commission, Robert Harris, Secretary, Montgomery, Alabama.

Securities Commission, Dover, Delaware.

Secretary of State, Springfield, Illinois.

Commissioner of Insurance, Securities Commission, Indianapolis, Indiana.

Securities Commissioner, Des Moines, Iowa.

Commission of Securities, Securities Division, Topeka, Kansas.

Division of Securities, Frankfort, Kentucky.

Insurance Commissioner, State Insurance Department of Maryland, Baltimore, Maryland.

Securities Commissioner, Jefferson City, Missouri.

Securities Commissioner, Columbus, Ohio.

Pennsylvania Securities Commission, Harrisburg, Pennsylvania.

Commissioner Department of Insurance and Banking, Nashville, Tennessee.

G. A. Bowles, Commissioner of Insurance, and C. M. Chichester, Director, Securities Division, Richmond, Virginia.

Insurance Commissioner, Charleston, West Virginia.

Securities Commissioner, Madison, Wisconsin.

Securities Commissioner, Tallahassee, Florida,

all persons heretofore designated either by name or official [fol. 22] position, and all other persons and officials not herein specifically named, who may have in their possession, custody or control, any assets, stocks, bonds, debentures, money, choses in action, real estate, personal property, or property of other kind or character, belonging to said debtor, shall forthwith surrender and deliver all such property to said Trustee; and all said persons and officials are hereby enjoined and restrained from in anywise interfering with the exclusive control and possession by said Trustee of said property and assets of said debtor, and are further enjoined and restrained from selling, assigning, concealing, encumbering, transferring, or otherwise disposing of or affecting any of said property and assets of said debtor.

It is further ordered and decreed that any and all property heretofore placed in the possession, custody or control of any state official by the Fidelity Assurance Association, the Fidelity Investment Association, or the Fidelity Investment Loan Association, whether the same be in the

form of stocks, bonds, debentures, money, or other form, for the purpose of securing the creditors or contract holders of the said Fidelity Assurance Association, Fidelity Investment Association, or Fidelity Investment Loan Association against loss occasioned by default in the payment of the amounts payable under said contracts, or for any other purpose, is hereby adjudged for the purposes of this order to be assets of the debtor herein and subject to this order.

Ben Moore, U. S. D. J.

(The Motion, referred to in the foregoing order, is in the words and figures as follows:)

[fols. 23-27] IN UNITED STATES DISTRICT COURT

[Title omitted]

MOTION FOR ORDER CLARIFYING AUTHORITY AND DUTIES OF TRUSTEE—Filed June 10, 1941

To the Honorable Ben Moore, Judge of the District Court of the United States for the Southern District of West Virginia:

Your Trustee in the above cause, Central Trust Company, now comes and respectfully shows unto Your Honor that the order heretofore entered herein approving the petition of the debtor does not name specifically the Receivers in the various states, who have in their custody and control assets of the debtor herein, and that the said order likewise fails to state specifically the names and official designations of the various state officials having custody and control of securities deposited in their respective states for the protection of contract holders. Your Trustee would further show unto the Court that the aforesaid order does not with sufficient clearness adjudge that securities deposited with the state officials in the various states wherein the debtor sold contracts for the purpose of securing the purchasers of said contracts against loss are property of the debtor herein and therefore subject to the control of this Trustee.

Your Trustee therefore respectfully moves the Court that said order be amended and clarified in the above particulars.

Central Trust Company, Trustee, by Counsel.

Townsend & Townsend, Counsel.

[fol. 28] IN UNITED STATES DISTRICT COURT

[Title omitted]

ORDER FILING MOTION—June 12, 1941

On the 9th day of June, 1941, came Ross B. Thomas and H. Isaiah Smith, by Koontz & Koontz, their attorneys, and related unto the Court that they were Receivers of the above named debtor, duly appointed by the Circuit Court of Kanawha County, West Virginia, and were served with a copy of the order of this Court entered June 6, 1941, demanding that certain assets of the debtor in their possession be turned over to the trustee appointed by this Honorable Court, and further enjoining and restraining them from further action as such Receivers, and thereupon ask the Court for permission to intervene in this cause and to file immediately a motion in this cause, and at a later time to file an answer and any other such proper pleadings as may be deemed necessary by them, and the Court thereupon granted to said Receivers such authority to intervene and to file any and all such proper motions, answers and pleadings as they may deem necessary.

Thereupon said Receivers, by their counsel, tendered for filing, in writing, a motion, which said motion is ordered by the Court filed, said motion asking a stay for a reasonable period of the execution and enforcement of the order of June 6, 1941, in so far as it relates to their turning over to the Trustee all of the assets and property of the debtor in their possession, and that such stay be had until certain legal matters going to the venue and jurisdiction of this Court and to the propriety of said order of June 6, 1941, be settled and determined; and the Court having heard arguments on said motion by the attorneys [fol. 29] for the said Receivers as well as by Townsend & Townsend, attorneys for the said Trustee, and having considered the matter fully, and being of opinion that any delay in the execution and enforcement of said order of June 6, 1941, would unduly restrict and hamper the Trustee in performing its duties thereunder, particularly with respect to assets of the debtor located outside the State of West Virginia, and for other reasons satisfactory to the Court, is of the opinion to and doth hereby refuse to grant the said motion, to which the said Receivers, by counsel, except.

And as to the several questions raised by said receivers in their said motion, the Court reserves its action thereon until such time as such questions shall be properly brought before the Court by appropriate motion or other suitable pleading.

And the said Receivers thereupon moved the Court that they be given a reasonable time within which to file their proper answer or other pleadings in this case, and there being no objection thereto, said motion is by the Court ordered granted.

Enter: Ben Moore, United States District Judge.

(The Motion, referred to in the foregoing order, is in the words and figures as follows:)

[fol. 30] IN UNITED STATES DISTRICT COURT

[Title omitted]

MOTION BY ROSS B. THOMAS AND H. ISAIAH SMITH, RECEIVERS OF DEBTOR—Filed June 12, 1941

On the 9th day of June, 1941, come now Ross B. Thomas and H. Isaiah Smith, by Koontz & Koontz, their counsel, and relate unto the Court that they are the Receivers of Fidelity Assurance Association, duly appointed by the Circuit Court of Kanawha County, West Virginia, in a proper suit brought by Edgar B. Sims, Auditor and Ex-Officio Insurance Commissioner of the State of West Virginia, and that they duly qualified as such Receivers, on the 11th day of April, 1941, by giving bond in the amount of $50,000.00 each, and that acting as such Receivers they have taken over all of the property and assets of the aforesaid debtor in the State of West Virginia, except that in the possession of Edgar B. Sims, as Auditor and Ex-Officio Insurance Commissioner of the State of West Virginia; that in an order entered in this Court on the 6th day of June, 1941, they are ordered to turn over all property and assets of the debtor in their possession to Central Trust Company, of Charleston, West Virginia, as Trustee of said debtor, and are enjoined from proceeding further or acting in said suit in Kanawha County, West Virginia.

Therefore, said Receivers, by counsel, move the Court that the execution or enforcement of said order of June 6, 1941, as it affects said Receivers, be stayed for a reasonable

period of time, until proper legal proceedings may be had to determine certain questions of law and equity, which go to the merits of the said order of June 6, 1941, and which question the legal validity of said order, and further raise the question as to whether the said suit is laid in the proper venue, and whether this Honorable Court has jurisdiction to act in the matter.

The following questions are raised by said Receivers, who maintain and submit that said order should be stayed until a legal determination is had of the matters raised by said questions:

1. The Court having failed to notify the Securities Exchange Commission of said proceeding before appointing [fol. 31] the Trustee, is the order for the appointment of the Trustee therefore void on its face?

2. Certain monies having been paid by contract holders of the debtor to these Receivers in trust, under the definite promise that the monies should be returned intact without charge for any expenses if reorganization fails and liquidation ensues, should not the order be modified so as to exempt specifically these funds?

3. Were the principal assets of the defendant, within the meaning of the Bankruptcy Act and Chapter 10 thereof, in the Southern District of West Virginia for a period of six months prior to the filing of the petition?

4. Is not the order void requiring the State Auditor of West Virginia to turn over to the Trustee the securities required by law to be deposited with him, and enjoining and restraining the said State Auditor from further action, because this is in effect a suit against the State of West Virginia and an interference with the discretionary administrative powers of an officer of the State of West Virginia; and is not the said order so void as to these Receivers appointed at his instance, who are in effect only his agents to hold the assets they possess for and on behalf of the said Auditor?

5. Was the petition filed in good faith as a factual matter; in view of Section 146(3) of Chapter X, was the petition filed in good faith; and in view of Section 146(4), was the petition filed in good faith?

Your petitioners respectfully represent unto the Court that these questions are so substantial and go to the merits of the matters involved that until there is a legal determination of these matters, there should be no change in the status quo as it now exists.

Respectfully submitted, Ross B. Thomas and H. Isaiah Smith, Receivers, By Counsel.

Kontz & Koontz, Counsel for Receivers.

[fol. 32] IN UNITED STATES DISTRICT COURT

[Title omitted]

ORDER DENYING MOTION—June 13, 1941

On the 9 day of June, 1941, came Edgar B. Sims, Auditor of the State of West Virginia and Ex-Officio Insurance Commissioner of the State of West Virginia, by Clarence W. Meadows, Attorney General of West Virginia, and Ira J. Partlow, Assistant Attorney General, and represented unto the Court that he, the said Sims, is the party plaintiff in a chancery cause pending in the Circuit Court of Kanawha County, West Virginia, against the above-named debtor, Fidelity Assurance Association, a corporation, which said cause was instituted by him pursuant to the statutes of West Virginia in such cases provided, and that he has been served with a copy of an order of this Court entered June 6, 1941, demanding that certain alleged assets of the debtor, being assets deposited with the Treasurer of the State of West Virginia by said debtor for the protection and benefit of contract holders of the debtor in the State of West Virginia, be turned over to the Trustee appointed by this Honorable Court in this proceeding, and enjoining and restraining him from any further action with respect to the assets of said debtor; whereupon, the said Edgar B. Sims, Auditor of the State of West Virginia and Ex-Officio Insurance Commissioner of the State of West Virginia, by counsel, requested permission of the Court to intervene in this cause and to forthwith file a motion therein, and at such later time as might appear proper, to file such answers or such other pertinent or necessary pleadings or pleas as may be deemed appropriate; whereupon, the Court granted [fol. 33] to the said Edgar B. Sims, Auditor of the State of West Virginia and Ex-Officio Insurance Commissioner of

the State of West Virginia, such right and authority to intervene herein at this time and to file hereafter any and all such proper motions, answers, pleas or pleadings as may seem necessary and appropriate.

Thereupon, the said Edgar B. Sims, Auditor, etc., by counsel, tendered and asked leave to file a motion in writing, which said motion is ordered filed and is filed, the same praying for a stay for a reasonable period of time of the execution and enforcement of the order of this Honorable Court entered on the 6 day of June, 1941, insofar as it relates to the turning over to the Trustee of all the alleged assets and property of the debtor in his, the said Sims' possession, and that such stay be in effect until certain legal phases of this case relating to the venue and jurisdiction of this Court and to the justness and propriety of said order of June 6, 1941, be legally determined and settled; and the Court having heard arguments on said motion by counsel for Edgar B. Sims, Auditor, etc., as well as by Townsend and Townsend, attorneys for the said Trustee, and having fully considered the matter and being of the opinion that any delay in the execution and enforcement of said order of June 6, 1941, would unduly restrict and hamper the Trustee in performing its duties thereunder, particularly with respect to assets of the debtor located outside the State of West Virginia, and for other reasons satisfactory to the Court, is of the opinion to and doth hereby refuse to grant said motion, to which action of the Court the said Edgar B. Sims, Auditor, etc., by counsel, objected and excepted.

As to the several questions raised by the said Edgar B. Sims, Auditor, etc., in his said motion, the Court reserves [fol. 34] any further action thereon until such time as such questions shall be again brought before the Court by appropriate motion or other suitable pleading.

Whereupon, the said Edgar B. Sims, Auditor of the State of West Virginia and Ex-Officio Insurance Commissioner of the State of West Virginia, by counsel, moved the Court that he be given a reasonable time within which to file his proper answer or other pleadings in this case, and there being no objection thereto, said motion is sustained and such leave granted.

Enter:

Ben Moore, United States District Judge.

The Motion, referred to in the foregoing order, is in the words and figures as follows:)

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[fol. 35] IN UNITED STATES DISTRICT COURT

[Title omitted]

MOTION OF EDGAR B. SIMS, AUDITOR OF THE STATE OF WEST VIRGINIA AND EX-OFFICIO INSURANCE COMMISSIONER OF THE STATE OF WEST VIRGINIA—Filed June 13, 1941

On the 9 day of June, 1941, came Edgar B. Sims, Auditor of the State of West Virginia and Ex-Officio Insurance Commissioner of the State of West Virginia, by counsel, representing unto the Court that he is the party plaintiff in a chancery cause pending in the Circuit Court of Kanawha County, West Virginia, against the above-named debtor, Fidelity Assurance Association, a corporation, which said suit was filed by him pursuant to the lawful powers, duties and authority provided in the statutes of the State of West Virginia, with respect to his supervision, control and direction of companies of the nature of said Fidelity Assurance Association, a corporation, and which suit was instituted in entire good faith and for the one and only purpose of protecting the contract holders of contracts with said Fidelity Assurance Association, a corporation, insofar as he, the said Edgar B. Sims, as Auditor and Ex-Officio Insurance Commissioner aforesaid, might be able so to do under the statutes of West Virginia and the authority and powers of the courts of West Virginia, particularly with reference to the proper administration of the assets deposited with the Treasurer of the State of West Virginia under the administrative control and supervision of the State Auditor and Ex-Officio Insurance Commissioner of said State, by said Fidelity Assurance Association, a corporation, for the protection and benefit of West Virginia holders of contracts with said Fidelity Assurance Association, a corporation; that in an order entered in this Court on the 6 day of June, 1941, he, the said Edgar B. Sims, as Auditor and Ex-Officio Insurance Commissioner of West Virginia, has purportedly been ordered by this Court to desist and stay any and all proceedings instituted

by him in this regard, and said order on the face thereof purports to command that he, the said Auditor and Ex-Officio Insurance Commissioner as aforesaid, turn over all [fol. 36] property and assets of the above debtor in his possession to Central Trust Company, of Charleston, West Virginia, as Truste for said debtor.

The said Edgar B. Sims, as Auditor and Ex-Officio Insurance Commissioner of West Virginia, by counsel, conceiving that grave questions of jurisdiction, venue and power of this Honorable Court may be involved with respect to the proceedings here instituted, now moves the Court that the execution and enforcement of said order of June 6, 1941, as it affects the said Edgar B. Sims, as State Auditor, etc., be stayed for a reasonable period of time until proper legal proceedings may be had to determine such questions of law and equity which may go the merits of said order of June 6, 1941, and to the legal validity thereof as to venue, jurisdiction and good faith.

As specific grounds for said motion, the said Edgar B. Sims, as Auditor, etc., respectfully submits that the following questions present themselves and should be fully considered by this Honorable Court and legally determined before said order of June 6, 1941, should be allowed to become fully effective in all respects:

1. The Securities and Exchange Commission was not notified of these proceedings as is provided by Federal law.

2. Prior to April 11, 1941, the only assets, which might in any manner be said to be those of the debtor in the Southern District of West Virginia, were certain securities which he, the said Edgar B. Sims, as Auditor, etc., required the debtor to deposit with the State Treasurer of West Virginia in trust for the benefit of said debtor's contract holders in the State of West Virginia, and which, under the provisions of law providing for such deposits in trust, and by the very nature thereof, are in effect constructively, if not actually, the property of said contract holders rather than that of said debtor; wherefore, the Southern District of West Virginia, not being the place of the principal office of said debtor and there being no assets of any appreciable value of the debtor therein, this Court is without jurisdiction in this proceeding.

3. Said order may be in effect an order against the sovereign State of West Virginia inasmuch as the Auditor and Ex-Officio Insurance Commissioner of said State is acting [fols. 37-40] in a purely official manner in this matter, and has in no wise, in the proceeding instituted in the Circuit Court of Kanawha County, acted as an individual or contrary to the statutes of West Virginia.

4. A serious question of good faith arises in this matter, actually and by Federal statute. Upon information and belief it is stated that the stockholders who have instituted this proceeding are the holders of stock utterly worthless and which cannot in any manner be made more valuable by any proceeding had here; that Section 146(3), Chapter X, of the Bankruptcy Act requires that it must be reasonable to expect a plan of reorganization to be effected when on the other hand every indication seems to point that it is entirely unreasonable to expect that such a plan can be effected, and certainly no plan which, considering the financial condition of the debtor, could in any way inure to the benefit of the stockholders as such; further, it is believed that the suit instituted in the Circuit Court of Kanawha County, West Virginia, now pending, is proper and one in which the interests of the creditors of the debtor would be best served, and hence under Section 146(4) of said Chapter X, of the Bankruptcy Act, the said Edgar B. Sims, as State Auditor, etc., should be allowed to proceed in said suit brought by him.

It is respectfully represented unto the Court that these questions are so substantial and go to the merits of the matters and things involved to the extent that until there is a legal determination thereof the order of June 6, 1941, should be stayed until such time.

Respectfully submitted, Edgar B. Sims, Auditor of the State of West Virginia and Ex-Officio Insurance Commissioner of the State of West Virginia, By Counsel.

Clarence W. Meadows, Attorney General; Ira J. Partlow, Assistant Attorney General, Of Counsel.

[fol. 41] IN UNITED STATES DISTRICT COURT

[Title omitted]

ORDER OF INTERVENTION BY SECURITIES & EXCHANGE COMMISSION—June 13, 1941

Request therefor having been duly made by me, pursuant to Section 208, of Chapter X of the Bankruptcy Act as amended, it is hereby

Ordered that the Securities & Exchange Commission be and it hereby is requested to file a notice of its appearance herein, and thereupon it shall be deemed to be a party in interest with the right to be heard on all matters arising herein, and shall be deemed to have intervened in respect of all matters herein with the same force and effect as if a petition for that purpose had been allowed by me; and it is further

Ordered that the Clerk of this Court be and he hereby is directed to accept no papers for filing or entry herein unless at the time such papers are tendered therefor two extra copies of such papers are delivered to said Clerk for service upon the Securities & Exchange Commission; and it is further

Ordered that the Clerk of this Court be and he hereby is authorized, empowered and directed forthwith to serve upon Edmund Burke, Jr. and Justin N. Reinhardt, attorneys for the Securities & Exchange Commission, at their office, No. 718-18th Street, N. W., Washington, D. C., two copies of each paper tendered for filing or entry herein; and it is further

Ordered that such service by the Clerk of this Court shall be in addition to and not in lieu of any and all notices or other documents required to be served by the parties herein upon the Securities & Exchange Commission in accordance with Section 265 a, of Chapter X of the Bankruptcy Act as amended, June 13, 1941.

Ben Moore, United States District Judge.

[fol. 42] IN UNITED STATES DISTRICT COURT

[Title omitted]

NOTICE OF APPEARANCE AND DEMAND—Filed June 13, 1941

Please Take Notice that the Securities and Exchange Commission hereby appears in this proceeding and requests that copies of all papers and notice of all matters arising herein be duly served on the undersigned at the address hereunder noted in accordance with Section 265(a) of Chapter X of the National Bankruptcy Act, as amended, and General Order 52 of General Orders in Bankruptcy of the Supreme Court of the United States, as amended.

Dated, Washington, D. C., June 12, 1941.

(S.) Edmund Burke, Jr., Justin N. Reinhardt, Attorneys for Securities and Exchange Commission, Office and P. O. Address, No. 718-18th Street, N. W., Washington, D. C.

To: Ira H. Motteshead, Clerk U. S. District Court for the Southern District of West Virginia; Central Trust Company, Charleston, West Virginia; James R. Fleming, Esq., 903 Old First Bank Building, Fort Wayne, Indiana; Allen G. Messick, Esq., 600 Bankers Bldg., Chicago, Illinois; Austin Wood, Esq., Board of Trade Building, Wheeling, West Virginia; Townsend and Townsend, 511 Kanawha Valley Bldg., Charleston, West Va.; Koontz & Koontz, Union Building, Charleston, West Va.; Clarence W. Meadows, Attorney General of W. Va., Charleston, West Va.

Filing Approved, June 13, 1941.

(S.) Ben Moore, United States District Judge.

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[fol. 43] IN UNITED STATES DISTRICT COURT

[Title omitted]

ORDER TO SEGREGATE, ETC.—June 14, 1941

This day came the Trustee herein and represented unto the Court that there have arisen certain questions concerning the custody and disposition of funds of the debtor now

in the custody of the Receivers heretofore appointed by the State Court; and it appearing to the Court from said representations of the Trustee, and from statements of counsel, that heretofore, to-wit, on April 11, 1941, there was instituted in the Circuit Court of Kanawha County, West Virginia, a certain equity suit, wherein Edgar B. Sims, Auditor and Ex-Officio Insurance Commissioner of West Virginia, was plaintiff, and the debtor herein was defendant, and wherein Ross B. Thomas and H. Isaiah Smith were appointed Receivers for said debtor; and it further appearing that prior to the institution of said suit, to-wit, on April 4, 1941, the said Sims, who then had under consideration the affairs of the debtor but had not yet reached a final decision as to what proceedings to institute, ordered said debtor herein to segregate the payments received from the debtor's installment contract holders on and after April 4, 1941, which was done, said payments being segregated by said debtor and placed in the National Exchange Bank of Wheeling, West Virginia, in a special account known as "F. S. Risley Special Account"; that upon the appointment of the Receivers on April 11, 1941, as aforesaid, a provision was contained in the order of appointment as follows:

"Third. That the said Receivers be and they hereby are authorized to collect the income, tolls, rents and profits of the said property, to accept or receive installment payments from holders of the defendant's annuity contracts, certificates and bonds becoming due on and after this date, pro- [fol. 44] vided, however, that said Receivers shall segregate all such payments and shall deposit the same in a bank account separate and apart from all other funds and income of the defendant, and hold the same subject to the further order and directions of this Court;"

and that pursuant to said order the said Receivers so collected monthly payments from debtor's installment contract holders and segregated the same from other funds of the company and deposited the same in the National Exchange Bank of Wheeling in an account known as "H. Isaiah Smith and Ross B. Thomas, Receivers for Fidelity Assurance Association, F. S. Risley Special Account", which said account is now being maintained and contains the sum of $167,900.35; that upon the appointment of the Receivers aforesaid the said "F. S. Risley Special Account" was transferred to the Receivers and is now main-

tained by them, but has since been transferred to the Charleston National Bank, where it is designated "H. Isaiah Smith and Ross B. Thomas, Receivers, Fidelity Assurance Association, Special Accounts Nos. 1, 2, 3, 4, 6, 9", which together contain the sum of $111,019.05; that on May 13, 1941, the aforesaid Receivers filed a report in the Circuit Court of Kanawha County, wherein they represented to the Court that they had received numerous inquiries as to the disposition of monthly installment contract payments made by contract holders subsequent to the receivership, and particularly whether said payments would be subject to the costs of the administration of the receivership; whereupon the said Circuit Court, on May 13, 1941, entered its order, the pertinent portion of which is as follows:

" . . . . it is adjudged, ordered and decreed:

1. That H. Isaiah Smith and Ross B. Thomas, Receivers, be, and they are hereby directed to maintain in separate accounts in their names the sums received by them in payment of contract installments from the defendant's contractholders held pursuant to Paragraph Third of Order No. 1 entered herein on the 11th day of April, 1941, and the net sums heretofore paid in to the escrow account designated 'F. S. Risley, Special Account,' which was ordered set up by the Insurance Commissioner of the State of West [fol. 45] Virginia, and subsequently taken into possession by the Receivers.

2. That all payments made by contractholders other than holders of Series B Contracts in which Section 6 and not Section 7 thereof, providing insurance protection, is effective, shall be held by the Receivers in the two special accounts designated in Paragraph (1) hereof provided for the purpose, and in event of ultimate liquidation of the defendant association said payments shall be returned intact, but without interest, to the contractholders who made the same, subject to no expenses of receivership or other deductions of whatsoever kind and character, whether the same shall have been received by the Association during the period from April 4th, 1941, to April 11th, 1941, and deposited in the 'F. S. Risley Special Account', or shall have been, or may hereafter be received by the Receivers on or subsequent to April 11th, 1941, and deposited in their special account provided for the purpose; and that all in-

stallment payments received as aforesaid from holders of the defendant's Series B Contracts, in which Section 6, providing insurance protection, and not Section 7, is effective, and deposited as aforesaid, shall in the event of ultimate liquidation of the Association likewise be returned intact, but without interest, to the contractholders who made the same, subject to no expenses or receivership or other deduction of whatsoever kind and character, except that there shall be deducted from the amount paid to each such contractholder the premiums actually paid to the insurance companies providing such insurance protection in respect of his contract * * *";

that subsequent to the entry of said order the contract holders of the debtor who made payments subsequent to said receivership were notified of the provision made for returning to them the payments made by them subsequent to the receivership as provided by the aforesaid order, and that the payments so made by said contract holders and received by the said Receivers were and are now deposited in the aforesaid separate bank accounts; that the question has been raised by Ross B. Thomas, Receiver aforesaid, concerning his liability to said installment contract holders who have made payments subsequent to the receivership and under the terms and conditions aforesaid in case he now delivers said funds to this Trustee under the order entered herein on June 6, 1941. Said Trustee further represented to the Court that certain contract holders of the debtor who had obtained loans on their contracts prior to the receivership have, since said receivership, paid the [fol. 46] interest requirements on said loans in order to prevent a forfeiture of such portion of the cash values of their contracts as remain with the Association over and above the amounts of their loans, and that many of said contract holders now desire to know whether said amounts so paid as interest on their loans will be returned to them intact in case of ultimate liquidation of the Association or will be commingled with the debtor's general funds.

Upon consideration of all of which, and it appearing to the Court that an order should now be entered upon the questions presented herein, it is adjudged, ordered and decreed:

1. That the Trustee herein shall segregate and keep in separate accounts on its books the funds delivered to it

from the aforesaid Receivers which have heretofore been deposited in the bank accounts designated as "F. S. Risley, Special Account" and "H. Isaiah Smith and Ross B. Thomas, Receivers for Fidelity Assurance Association, F. S. Risley, Special Account"; that all payments made by contract holders between April 4, 1941, and August 5, 1941, inclusive, be held by said Trustee in separate accounts aforesaid, and that all contract holders who have made payments between said dates shall be permitted, upon request, to withdraw the same in accordance with the order of the Circuit Court aforesaid. Notice of such right of withdrawal shall be given said contract holders who have so made such payments by the Trustee on or before July 5, 1941, and such withdrawals shall be permitted only by those contract holders who elect to do so and who notify the Trustee of such election on or before August 5, 1941; and all payments so made between April 4, 1941, and August 5, 1941, and not withdrawn as hereinabove provided shall be held by said Trustee and administered the same as payments received on or after August 5, 1941, as hereinafter provided; that payments made by contract holders on and after August 6, 1941, be segregated by said Trustee and maintained in another separate account, and in the event no [fol. 47] plan of reorganization is adopted and approved by the Court and approved by two-thirds of the class of contract holders affected thereby, such installment payments shall be returned intact, and subject to none of the costs or expenses of this proceeding, to the contract holders who make said payments, but without interest, except, however, that in the case of contract holders holding Series B Contracts in which section thereof, providing insurance protection, and not section 7, is effective, such installments shall be so returned to each such contract holder after there has been deducted therefrom the amounts actually paid in premiums to the insurance companies which provided the insurance in respect to his contract.

2. That the Trustee herein shall segregate and keep on its books another separate account wherein shall be credited all money paid to it by contract holders of the debtor as interest on loans heretofore obtained by said contract holders on their contracts, which shall be held in such separate account subject to the further order of this Court.

Ben Moore, U. S. D. J.

[fols. 48-57] IN UNITED STATES DISTRICT COURT

[Title omitted]

ORDER FILING ANSWER OF EDWARD W. DRIEHORST, ET AL., CREDITORS CONTROVERTING THE ALLEGATIONS OF DEBTOR'S PETITION—June 23, 1941

This 23rd day of June, 1941, came on the above matter and it now appearing to the Court that Edward W. Driehorst, H. C. Ogden, Trustee for Frances Ogden Stubblefield, H. C. Ogden, Trustee for Margaret Lawson Stubblefield, H. C. Ogden, Trustee for Anne McEwen Stubblefield, Charles E. Bates, Trustee for Eugenia C. Bates, Ohio Valley Lithographing Co., Mary V. Nager, Mrs. A. L. Jones, Edwin C. Jepson, George C. Dannenberg or Emily K. Dannenberg, Trustee for George C. Dannenberg, Jr., and George S. Kender, on behalf of themselves and all other persons similarly situated, creditors of the Fidelity Assurance Association, the abovenamed debtor, have this day tendered for filing their answer controverting the allegations of the petition heretofore filed in this proceeding upon the 6th day of June, 1941, under the terms and provisions of Section 137 of Chapter 10 of the Acts of Congress relating to bankruptcy, as amended, it is, upon motion of Austin V. Wood and Charles P. Mead, their attorneys, Ordered that said answer controverting the allegations of said debtor's petition be and the same is hereby ordered filed herein.

Ben Moore, United States District Judge.

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[fol. 58] IN UNITED STATES DISTRICT COURT

[Title omitted]

ORDER COUNTERMANDING AUTHORITY OF THE TRUSTEE TO EMPLOY ALLEN G. MESSICK FOR SPECIAL SERVICES

This day came the Central Trust Company, Trustee herein, and filed its petition, requesting that its authority heretofore granted herein by order entered June 7, 1941, authorizing the said Trustee to employ one Allen G. Messick for special services during the period of the administration of this trust be countermanded.

And the Court having examined said petition and being fully advised in the premises now grants said petition, and hereby revokes and countermands the authority heretofore granted the Trustee to employ the said Allen G. Messick for the performance of such special services as required by the Trustee in the administration of this trust.

Dated this 24th day of June, 1941.

Ben Moore, U. S. D. J.

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(The Petition, referred to in the foregoing order, is in the words and figures as follows:)

[fols. 59-60] IN UNITED STATES DISTRICT COURT

[Title omitted]

PETITION FOR AUTHORITY TO DISPENSE WITH THE SERVICES OF ALLEN G. MESSICK—Filed June 24, 1941

To The Honorable Ben Moore, Judge Of The District Court Of The United States For The Southern District Of West Virginia:

Now comes the Central Trust Company, Trustee herein, and respectfully shows the Court that under an order heretofore entered herein on June 7, 1941, your Trustee was authorized and empowered by the Court, pursuant to section 157 of chapter 10 of the Federal Bankruptcy Act, to employ one Allen G. Messick, Chairman of the Board of Directors of said debtor, for special services for the purpose of assisting your Trustee in marshalling the assets of said debtor and for the purpose of assisting your Trustee in the development and formulation of a plan of reorganization for the affairs of the debtor. Your Trustee would now respectfully represent unto the Court that it does not deem it necessary to so engage the services of the said Allen G. Messick.

Wherefore your petitioner prays that an order be entered by the Court countermanding the authority of your Trustee to employ the said Allen G. Messick as aforesaid.

Central Trust Company, Trustee. By A. A. Payne, Vice President and Trust Officer.

[fol. 61] IN UNITED STATES DISTRICT COURT

[Title omitted]

PETITION FOR LEAVE TO INTERVENE—Filed June 27, 1941

To The Honorable Judge Of The District Court Of The United States For The Southern District Of West Virginia:

The petition of the Banking Commission of the State of Wisconsin respectfully alleges:

1. That on June 6, 1941 the petition of Fidelity Assurance Association was filed herein praying that said debtor be reorganized under the provisions of Chapter 10 of the Bankruptcy Act.

2. That said Fidelity Assurance Association was licensed to do business in the State of Wisconsin as an "investment association" under the provisions of Chapter 216, Wisconsin Statutes, on June 26, 1930, and did business in the State of Wisconsin as such "investment association" from June 26, 1930 to approximately April 14, 1941.

3. That under the provisions of Chapter 216, Wisconsin Statutes, applicable to said Fidelity Assurance Association, it is provided that all of the provisions of Chapter 215, Wisconsin Statutes, with respect to the supervision, control and conditions upon which foreign building and loan associations are permitted to do business in the State of Wisconsin are applicable to and imposed upon said Fidelity Assurance Association, the same as though said Association was a foreign building and loan association authorized to do business in the State of Wisconsin, so far as such supervision, con-[fol. 62] trol and conditions can be made applicable to the particular business done by said Association.

4. That during the time when said Fidelity Assurance Association was licensed and doing business in the State of Wisconsin, said Association was, under the provisions of Chapter 215 and Chapter 216, Wisconsin Statutes, subject to the supervision and control of the Banking Commission of Wisconsin and has been licensed annually by said Commission.

5. That in order to do business in the State of Wisconsin, said Association was, under the provisions of Sections

215.38, 215.39 and 215.395, Wisconsin Statutes, compelled to have and keep on deposit with the State Treasurer of Wisconsin in trust for the benefit and security of Wisconsin contract, bond or certificate holders of said Association until all of said Association's contracts and obligations to persons residing in the State of Wisconsin shall have been fully performed and discharged, securities of certain nature and kind as specified in said statutes in an amount equal to at least one hundred ten (110%) per cent of the liability of said Association on contracts, bonds or certificates outstanding or contracted for by persons residing in the State of Wisconsin.

6. That in accordance with the requirements of said statutes, Fidelity Assurance Association deposited with the State Treasurer of Wisconsin securities having an approximate market value as of February 28, 1941 of $2,606,883.16 with unpaid interest coupons appertaining thereto in a sum of approximately $28,394.53 to secure its liabilities to Wisconsin residents as aforesaid.

7. That under the provisions of Chapter 215, Wisconsin Statutes, applicable to Fidelity Assurance Association, the [fol. 63] Banking Commission of Wisconsin is given the right and has the duty of taking possession of the business and property of said Association located in the State of Wisconsin whenever the Commission shall find that said Association is conducting its business in an unauthorized or unsafe manner, or is in an unsound or unsafe condition to transact its business, or has an impairment of its capital, or cannot with safety and expediency continue business, or has suspended payment of its obligations, and that the Banking Commission of Wisconsin, having on April 14, 1941 found that said conditions existed, the said Commission did, on April 14, 1941, acting pursuant to the provisions of Chapter 215, Wisconsin Statutes, appertaining thereto, take possession and control of all of the business and property of said Fidelity Assurance Association located in the State of Wisconsin, and by said action and by order of the Circuit Court for Dane County, Wisconsin entered April 14, 1941, the Banking Commission of Wisconsin was vested with the title to all of the Wisconsin assets and property of said Association including the aforementioned deposit.

8. That the Banking Commission of Wisconsin has, since April 14, 1941, acting by itself and through Howard L. Smith, Special Deputy Commissioner of Banking duly appointed to assist in the duty of liquidation and distribution of the Wisconsin assets of said Fidelity Assurance Association, and acting under orders of the Circuit Court for Dane County, Wisconsin, duly entered, proceeded to administer and liquidate the Wisconsin assets of said Fidelity Assurance Association for the benefit of contract, bond and certificate holders of said Association residing in the State of Wisconsin.

9. That, acting under orders of the Circuit Court for [fol. 64] Dane County, Wisconsin, the Banking Commission of Wisconsin has, in accordance with the statutes of Wisconsin in such case made and provided, proceeded to give notice to all Wisconsin residents holding contracts, bonds or certificates of said Fidelity Assurance Association to file their claims with the Banking Commission of Wisconsin, such notices having been given to approximately 6,200 residents of Wisconsin who are holders of contracts, bonds or certificates of said Fidelity Assurance Association, and that the greater portion of said Wisconsin contract holders have now filed their claims with the Banking Commission of Wisconsin in said proceeding.

10. That, as the Banking Commission of Wisconsin is informed and believes, said Fidelity Assurance Association was on June 6, 1941, at which time its petition herein was filed, and is presently, chartered as an insurance corporation under the laws of the State of West Virginia, the state where said Association is incorporated, and therefore is not a corporation which could be adjudged a bankrupt under the Bankruptcy Act and is not a corporation which could be reorganized under the provisions of Chapter 10 of the Bankruptcy Act, and by reason thereof, the court herein is wholly without jurisdiction in this matter.

11. That the petition filed by Fidelity Assurance Association was not filed in good faith within the meaning of Chapter 10 of the Bankruptcy Act in that it is unreasonable to expect that a plan of reorganization can be effected herein for the reason, among others, that prior proceedings are pending in a court of the State of Wisconsin, as hereinbefore set forth, and that the interests of Wisconsin creditors

of Fidelity Assurance Association herein should be dismissed.

[fol. 65] 12. That the Banking Commission of Wisconsin maintains that the deposit made with the State Treasurer of Wisconsin in trust for the benefit and security of all contract holders resident in Wisconsin may be administered and applied only for the benefit of such Wisconsin residents, and said deposit having been made under provisions of the Wisconsin Statutes adopted by the State of Wisconsin in the exercise of its sovereign power as a condition precedent upon which Fidelity Assurance Association was authorized to do business in the State of Wisconsin, and the statutes of the State of Wisconsin providing a complete scheme for the administration of such assets for the benefit of Wisconsin contract holders, the court herein is wholly without jurisdiction to take possession of or administer any of said assets so deposited in Wisconsin or to affect the rights of contract holders resident in Wisconsin in such deposited assets, and that any law purporting to give such jurisdiction to this court would be unconstitutional and void.

13. That, as the Banking Commission of Wisconsin is informed and believes, all of the assets of Fidelity Assurance Association are on deposit with state authorities either in the State of West Virginia, the place of incorporation of said Association, or in other states in which said Association does business, said Association having done business in approximately nineteen (19) states of the United States. That in a large number of such states, including the State of West Virginia, proceedings were, prior to the filing of the petition herein, commenced for the purpose of liquidating the funds so on deposit in such states for the benefit of contract holders, and that, as the Banking Commission of Wisconsin is informed and believes, the state authorities of a large number of said states other than the State of Wis-[fol. 66] consin also will deny and contest the jurisdiction of the court herein on grounds similar to those urged herein or on other grounds, and that these circumstances further demonstrate that the petition herein is not, within the meaning of Chapter 10 of the Bankruptcy Act, filed in good faith in that if the petition herein is not dismissed, thousands of contract holders in the State of Wisconsin and elsewhere will have to await the payment of their just claims until such questions are determined in lengthy and costly litigation,

and that this fact conclusively demonstrates that the interests of the creditors of Fidelity Assurance Association would be best subserved in the prior proceedings already instituted in the State of Wisconsin and in various other states for the benefit of such contract holders.

14. That, as further bearing on the question of good faith herein, it is wholly unreasonable to expect that a plan of reorganization can be effected for the further reason that should the assets of Fidelity Assurance Association now on deposit with the State of Wisconsin and other states be turned over to a trustee appointed herein, said Association would at the instant such deposits were so turned over and removed from the possession and control of such state authorities, be without power to transact further business in such states and thus any attempt to reorganize such corporation by proceedings taken in derogation of state deposit laws must prove futile.

15. That the Banking Commission of Wisconsin, by reason of the facts and circumstances as herebefore alleged, has an interest in these proceedings and desires to intervene herein for the purpose of contesting the jurisdiction of the court upon the grounds as generally set forth herein or upon such other grounds as may be proper.

[fols. 67-68] Wherefore, the Banking Commission of Wisconsin prays that an order be entered giving said Commission leave to intervene in this proceeding for the purpose of moving to dismiss said petition, moving to vacate any orders heretofore entered affecting the interests of this petitioner or to file its answer controverting the facts alleged in said petition and setting up the grounds for the dismissal thereof, and that the court enter its further order designating that the Banking Commission of Wisconsin be given notice of all matters and proceedings herein.

Banking Commission of Wisconsin, by (S.) Frank H. Bixby, Commissioner; (S.) John E. Martin, Attorney General of the State of Wisconsin; (S.) Rickard H. Lauritzen, Assistant Attorney General, Attorneys for Banking Commission of Wisconsin.

Dated June 24th, 1941.

*Duly sworn to by Frank H. Bixby. Jurat omitted in printing.*

[fol. 69] IN UNITED STATES DISTRICT COURT

[Title omitted]

PETITION REQUESTING FURTHER INSTRUCTIONS OF THE COURT IN RESPECT TO THE OPERATION OF THE DEBTOR'S BUSINESS—Filed July 3, 1941

To the Honorable Ben Moore, Judge of the District Court of the United States for the Southern District of West Virginia:

I

Your petitioner is the duly qualified and acting Trustee herein. By an order dated June 6, 1941, your petitioner was authorized, empowered and directed to conduct the business of the debtor herein. Your petitioner desires to submit to the court certain problems in the conduct of the business of the debtor herein which have arisen or which in the opinion of your petitioner are likely to arise, and as to which your petitioner prays the instructions of this Court.

II

The business of the debtor herein consists essentially of four phases: (1) Receipt of money from contract holders; (2) payment of money to contract holders; (3) making investments; and (4) liquidating investments. Each of these phases of the debtor's business involves questions of policy, which your petitioner feels are matters which should properly be decided by the Court after it has had the benefit of an expression of views thereon by the parties interested herein.

III

This proceeding supersedes a proceeding in the State Court of the State of West Virginia, in which H. Isaiah Smith and Ross B. Thomas were appointed Receivers of the assets and property of the debtor herein. Pursuant to the order of this Court said Receivers are turning over to your petitioner the assets of the debtor which they have reduced to possession. In said State Court proceeding an order was entered directing the said Receivers to accept payments from holders of contracts issued by the debtor herein, despite the pendency of said proceeding, but to hold such pay-
[fol. 70] ments in trust for the benefit of the contract holders

making such payments, except to the extent that insurance premiums were paid to the Lincoln National Life Insurance Company on behalf of contract holders of Series B as to which paragraph 6 is applicable. The order of said Court authorized that such premiums so paid might be deducted from the amounts paid by such contract holders of the debtor herein and the balance of such payments be held in trust as aforesaid. By an order entered herein on June 14, 1941, your petitioner was directed to continue the procedure set forth in said prior order of the State Court. Your petitioner represents to the Court that under the order of June 14 aforesaid, payments received from contract holders may not be invested by your petitioner but must be held in trust by your petitioner for the persons making such payments and must be returned by your petitioner to said persons upon request. Accordingly, your petitioner is advising all contract holders of this arrangement in a notice dated July 3, 1941, a copy of which is annexed hereto and made a part hereof and marked "Exhibit A". The receipt of such payments by contract holders of the debtor herein involves substantial expense to the estate. The refunding of such payments involved additional expense to the estate. To the extent that the sums so paid by the debtor's contract holders are retained by your petitioner as Trustee herein, they result to no benefit to the estate by way of income or otherwise. Your petitioner submits, therefore, for the consideration of this Court and of the interested parties the question whether your petitioner should be required to continue to receive such payments from the contract holders of the debtor.

IV

A decision as to the question submitted in the foregoing paragraph involves a further question with relation to those contracts of the debtor which bear insurance features. Contracts known as Series B contain a paragraph numbered 6 which provides as follows:

"Section 6. Insurance Protection. If this Section 6 (and not Section 7) is made effective at issue, as set forth on the fact of this contract, the Association has arranged for Life Insurance under a group and/or individual legal reserve life insurance policy covering the original registered holder of this contract provided he be in good health

and has been accepted by the Insurance Company at the date of its issue.

"(Protection for Contract) Said policy provides that upon receipt of due proof of death of such registered holder occurring while said policy is in force and while insured thereunder, and subject to the terms, conditions and privileges set forth in said policy, the Insurance Company issuing [fol. 71] said policy will pay to the Association an amount required by the Association to declare this contract fully paid.

"(Fully Paid Contract) Upon receipt of due proof of the death of such registered holder on forms prescribed by the Association and of the money from the Insurance Company in accordance with the above, the Association will declare this contract fully paid, and upon presentation will make suitable endorsement thereon; provided that if said due proof of the death of such registered holder and/or the money from the Insurance Company shall be received by the Association later than one month after the last month for which monthly payments have been made, the Association will require an exchange of this contract for another of the same form and amount, and endorsed fully paid, but maturing later than this contract by a period equal to the months then elapsed after the month of last monthly payment made hereon.

"(No further Payments) In declaring a contract fully paid the Association waives the payment of all monthly payments that have not been made. The contract, when declared fully paid, may remain in effect to maturity, otherwise unchanged as to terms and privileges, except that it shall have increased cash availability.

"(Increased Cash Availability) The cash availability of a contract declared fully paid shall be as shown in a cash surrender schedule to be endorsed hereon, making available an amount equal to eighty-six monthly payments, at the end of the first month for monthly payments, and a progressively greater amount at the end of each later month, by one-third of one monthly payment, to the eighty-third month inclusive, and thereafter by two-fifths of one monthly payment to the one hundred eighth month inclusive, and thereafrer by two-thirds of one monthly payment to the one hundred twenty-sixth month inclusive.

"(Conditions of Protection) The policy issued by the insurance company provides that the benefits thereunder will

not be available (a) if the original registered holder of this contract shall die while more than three months in arrears in any payment thereon, or (b) if such registered holder shall commit suicide while sane or insane within two years from the date of this contract, or (c) if such registered holder has made any material misrepresentation or false statement as a basis for obtaining the insurance protection provided in this Section, or (d) if such registered holder cease to be the registered holder of this contract.

"(Termination of Protection) In conformity with the terms of this contract and the policy issued by the insurance company, the insurance protection hereunder will terminate (a) at the expiration of three months from the due date of any monthly payment not duly paid within such period, or (b) upon the date of any transfer of this contract upon the books of the Association, or (c) if this contract be surrendered for a paid-up contract or for its cash value, or (d) if any indebtedness to the Association, and/or interest thereon, be not duly paid when due or within the grace period, if any, allowed for such payment, or (e) when all monthly payments required hereunder shall have been duly paid or this contract be declared fully paid. No paid up contract shall have insurance protection. If this contract be exchanged, without transfer, for a new contract of the same form and amount while the insurance pro-[fol. 72] tection remains in effect according to the terms of this Section 6, the insurance protection will be continued according to the terms of this contract.

"(Reinstatement of Protection) If insurance protection hereunder be terminated in any manner, before declaration that this contract is fully paid, or before all monthly payments hereon have been duly paid, and this contract be continued or replaced by reinstatement, reissue or transfer according to its terms, or otherwise, insurance protection may be obtained upon the life of the same or the substituted registered holder (as the case may be) only if accepted for such protection by the life insurance company after submission of evidence of insurability as required by said company, and only subject to the same conditions as for a newly issued contract. If this contract is at any time without insurance protection before declaration that this contract is fully paid, or before one hundred twenty monthly payments hereon have been duly paid, the provisions of Section 7 shall apply.

"(Reserve Requirements) Upon declaring the contract fully paid, the Association shall set aside in the Maturity and Retirement Reserve Fund such amount, in addition to the required accumulation in the Reserve Fund for such contract as prescribed in Section 1 hereof, as is necessary to meet the liability for the increased cash availability of such fully paid contract and the waiver of monthly payments not already paid, and shall, upon the due dates of such subsequent monthly payments (no longer required) transfer from the Maturity and Retirement Reserve Fund to the Reserve Fund such amounts as would otherwise have been set aside in the Reserve Fund from such monthly payments.

"Section 6. Insurance Protection. (Continued.)

(General Terms) Nothing contained in this contract shall be deemed to be a representation or promise on the part of the said Insurance Company, or as placing the said Insurance Company under any accountability or responsibility whatsoever to such registered holder, but its entire responsibility shall be exclusively to the Association under the policy issued and is to be determined wholly in accordance with the terms and conditions of said policy. It shall be the duty of the Association to continue the said policy as long as necessary hereunder, but if said policy shall terminate for any reason whatsoever while such protection of such registered holder remains necessary hereunder, the Association will endeavor to replace such protection in a legal reserve life insurance company; and should for any reason beyond the control of the Association such replacement prove impracticable, the Association will so notify such registered holder. No suit for benefits under this Section 6 may be brought against the Association after one year from the death of such registered holder, unless by statute applicable to this contract a longer minimum period is prescribed, in which case such period shall apply hereunder."

Of the contracts of the debtor now in force, approximately fifteen thousand involve the operation of said paragraph 6 [fol. 73] and carry such insurance feature. In order to maintain said insurance in force it is, of course, necessary to make current payments of premiums thereon. The State Court, in the prior receivership proceeding, authorized, empowered and directed its Receivers to make such current premium payments out of sums received from the debtor's

contract holders. If the within proceeding should result in a liquidation or even in a substantial modification of the debtor's outstanding contracts, it may prove to have been detrimental to the holders of such contracts bearing insurance features to have continued making payments of premiums to maintain such insurance obligation in force. On the other hand, if the within proceeding should result in a reorganization which effects no substantial change in the debtor's existing contracts, serious detriment may result to the debtor's contract holders from a failure to maintain such insurance provisions in force. Accordingly, your petitioner has instituted negotiations with the Lincoln National Life Insurance Company, the obligor under said insurance contracts, with a view to effecting a moratorium of premium payments and benefit payments during the pendency of this proceeding, without, however, impairing the effectiveness and operation of the existing insurance contracts. If your petitioner should succeed in working out such a moratorium it will so advise your Court and ask for authority to enter into such arrangement and approval of the contract embodying such arrangement. However, if your petitioner should be unsuccessful in its attempts to negotiate such a moratorium, serious question will arise as to the desirability of continuing premium payments on behalf of holders of contracts of the debtor with insurance features. On this question also your petitioner seeks the advice and direction of the Court.

V

Your petitioner is informed and believes that the extent and nature of the property and assets of the debtor herein, as well as the extent and nature of its liabilities, must be determined as of the date of the institution of the within proceeding, namely, June 6, 1941. If that is so, it follows that payments made by contract holders to your petitioner as Trustee subsequent to the institution of this proceeding do not become assets of the debtor for the purpose of this proceeding. It also follows that the liability of the debtor on its contracts cannot be increased or reduced by any action of the debtor, your petitioner, or the contract holders of the debtor which occurred subsequent to the filing of the [fol. 74] petition herein. Your petitioner therefore asks that pending the determination of the questions raised in this petition that this Court enter an order fixing the rights

of contract holders of the debtor as of the date of the institution of the within proceeding and preserving such rights regardless of the continuance of such contract holders to make payments to your petitioner or to the debtor herein in accordance with their respective contracts, except insofar as it shall be found necessary to continue paying premiums on insurance to maintain it in force, as discussed hereinabove. The order to be entered hereon will, of course, be subject to re-examination and revision as a result of the plenary hearing which is contemplated herein.

VI

Certain of the contracts of the debtor herein have matured and been paid off in full. Others have matured and prior to the institution of this proceeding and the prior receivership proceeding were being paid off in monthly installments. Certain of the contracts of the debtor herein will mature during the pendency of this proceeding. All the contracts of the debtor herein have a specified cash surrender value. Demands have been made upon your petitioner for payments in accordance with one or more of such alternative obligations of the debtor. Your petitioner has consistently refused to make any payments to the debtor's contract holders out of funds of the debtor. The assets of the debtor include substantial sums of cash which are not needed in the administration of this proceeding. Your petitioner seeks the advice and instructions of this Court as to the extent to which it should make payments to holders of contracts of the debtor who desire such payments. In this connection your petitioner points out that each series of contracts issued by the debtor contemplates the segregation of certain assets to which the holders of contracts of such series may have recourse in satisfaction of their claim under such contracts. Moreover, substantial proportions of the debtor's assets have been deposited with official agencies of the various states in which the debtor was authorized to do business. Your petitioner is now engaged in seeking to reduce to possession assets of the debtor so deposited. Your petitioner also represents that holders of certain series of the debtor's contracts have received payments out of funds borrowed from assets of the debtor segregated for the benefit of the [fol. 75] debtor's contracts of other series. Your petitioner

will submit as soon as possible a detailed report as to the foregoing. It is mentioned in this petition insofar as it has bearing upon the question raised as to the extent to which your petitioner may make payments to holders of contracts of the various series issued by this debtor.

VII

To the extent that the estate of the debtor herein consists of cash, your petitioner is uncertain as to its duty to invest said cash in income-producing securities. If it should make such investment your petitioner desires to be advised whether it is restricted to investments which are legal for trust funds in the State of West Virginia. The foregoing problem is rendered more acute to the extent that securities constituting assets of the debtor herein pay interest or dividends in the form of cash which comes into the possession of your petitioner and to the extent that securities constituting assets of the debtor herein are called and paid off in cash which comes into the possession of your petitioner as Trustee.

VIII

In view of the fact that a substantial proportion of the assets of the debtor herein in the hands of your Trustee consists of securities having a readily ascertainable market value, your petitioner is faced with the problem whether it should reduce all such securities to cash or, in the alternative, whether it should reduce to cash only such securities as in the opinion of your petitioner represent sound investments, or whether some other test should be adopted by your petitioner. On all of these questions your petitioner seeks the advice and instructions of this Court.

IX

Included in the assets of this estate are shares consisting of all the presently issued and outstanding stock of a corporation known as Fidel Association of New York, Incorporated, This corporation was incorporated under the laws of the State of New York. It is engaged in the sale of contracts similar to the contracts issued by the debtor herein and conducts all the activities of a corporation engaged in such business. The contracts so issued by said Fidel Association of New York, Incorporated, are guaranteed by

the debtor herein. Notice of the pendency of the within proceeding is being given to holders of contracts issued by said Fidel Association. Your petitioner is undecided, and [fol. 76] therefore seeks the advice and instructions of this Court, as to the following:

1. Should your petitioner displace the present officers and directors of Fidel Association of New York, Incorporated, with officers and directors chosen by your petitioner and answerable to your petitioner?

2. Should your petitioner file a petition against or on behalf of said Fidel Association as a subsidiary of the debtor herein in this proceeding and subject said Fidel Association and its assets to the jurisdiction of this Court and the operation of this proceeding?

3. Arrangements were made by the Receivers appointed in the State Court receivership, which preceded the within proceeding, whereby the Colonial Trust Company of New York was appointed successor Trustee under the contracts issued by said Fidel Association in place of Charleston National Bank, Trustee. Said Receivers entered into an arrangement with said Colonial Trust Company, whereby the latter agreed that in the event any holder of a contract issued by the Fidel Association should desire to make a loan from the debtor herein pursuant to the terms of his contract that such loan would be made by said Colonial Trust Company in lieu of the debtor herein, said Trust Company taking as security therefor the reserve value behind the contract as to which the loan was made. Your petitioner has taken no steps to continue in force the said agreement between the prior Receivers and the Colonial Trust Company, and your petitioner seeks the advice and instructions of this Court as to whether it should enter into such an arrangement with said Colonial Trust Company or enter into any other arrangement designed to accomplish the same end, or to discharge in some other way the obligation of the debtor herein to make loans to the holders of contracts issued by said Fidel Association, or whether your petitioner should in no way seek to discharge the obligation of the debtor herein to make such loans as aforesaid.

Central Trust Company, Trustee, By A. A. Payne, Vice-President. Townsend and Townsend, Attorneys.

[fol. 77] *Duly sworn to by A. A. Payne. Jurat omitted in printing.*

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[fols. 78-93] EXHIBIT "A" TO PETITION

Central Trust Company, Trustee, for Fidelity Assurance Association, Wheeling, West Virginia.

To the Contract Owners and Creditors of Fidelity Assurance Association (formerly Fidelity Investment Association and Fidelity Investment and Loan Association):

1. On June 6, 1941, Honorable Ben Moore, Judge of the District Court of the United States for the Southern District of West Virginia, approved a petition for reorganization filed by the Fidelity Assurance Association under Chapter X of the Federal Bankruptcy Act. The purpose of the proceeding is to effectuate a financial and structural reorganization of the company, which, according to the allegations of the petition, is unable to meet its debts as they mature.

2. The Central Trust Company, of Charleston, West Virginia, was appointed Trustee of the debtor (as the Fidelity is called in this proceeding.) It is now engaged in marshalling and conserving the assets of the debtor for the benefit of its creditors and contract holders with a view to formulating a plan of reorganization for the debtor and its property. To that end the Trustee is undertaking an investigation, among other things, of the debtor, the operation of its business and the desirability of the continuance thereof, a report of which investigation will be submitted to the Court and, in such form and manner as the Judge may direct, to the creditors, stockholders and Indenture Trustees, the Securities and Exchange Commission and such other persons as the Judge may designate. Suggestions for the formulation of a plan or proposals in the form of plans may be submitted to the Trustee on or before September 5, 1941, or such later time as the Judge may fix.

3. If it is found desirable to continue the business of the debtor, a plan or plans will be submitted to the Court. The Judge will submit to the Securities and Exchange Commission for examination and report the plan or plans which the Judge regards as worthy of consideration. Thereafter, any plan which, in the opinion of the Court, complies with

the provisions of the Federal Bankruptcy Act and which is fair and equitable and feasible, will be approved by the Judge and submitted to the creditors and stockholders affected thereby. If a plan is accepted in writing by creditors holding two-thirds in amount of the claims filed and allowed of each class, and, if the debtor has not been found to be insolvent, by or on behalf of stockholders holding the majority of stock, of which proofs have been filed and allowed of each class affected by the plan, the Judge, after hearing, may confirm such plan and declare it effective as to the debtor, its property, its creditors and stockholders and all other persons interested in or having claims against the debtor or its property.

4. It is the duty and desire of the Trustee to protect the interests of the contract holders and creditors and all other persons interested in or having claims against the debtor or its property, wherever located, and every effort will be made to effect a reorganization of the debtor, under the direction of the Federal Court. However, if it should prove impossible to consummate a fair and equitable and feasible plan of reorganization in the manner above described, the Court will either dismiss the proceedings or direct a liquidation of the debtor and its assets. In the latter event, the property of the debtor, which is almost entirely in the form of liquid assets composed of stocks, bonds and other forms of securities, will be sold and the proceeds paid to the creditors and contract holders of the debtor. If all claims against the debtor should be paid in full, any balance remaining would be distributed to the stockholders of the debtor.

5. Prior to the institution of this proceeding, the Circuit Court of Kanawha County, West Virginia, appointed Receivers for the debtor in a proceeding instituted in that Court on April 11, 1941. The Receivers appointed under that proceeding, Ross B. Thomas and H. Isaiah Smith, of Charleston, West Virginia, have been ordered to surrender and deliver all of the assets in their possession to the Trustee herein. They are currently complying with said Order.

6. Under the Circuit Court proceeding, which is now superseded by this one, the contract holders were informed that monthly payments on their contracts made by them

during the receivership would be held intact by the Receivers and in case of ultimate liquidation would be returned to them in full, but without interest, except that in the case of Series B contracts in which paragraph 6, providing life insurance, was effective, such payments would be returned, less deductions made for payment of the insurance premiums. In the present proceedings in the Federal Court, the Court has entered an order to the same effect, i. e., the Trustee is required to segregate payments made after the State Court receivership and payments made pending the present Federal proceeding, and hold the same in trust to be returned to the contract holders upon request.

7. If payments made after the beginning of the State Court proceeding (April 11) are permitted to remain with the Trustee, the Trustee will, by order of the Federal Court entered June 14, keep segregated such payments, and in case of ultimate liquidation such payments will be returned to the persons making them, intact but without interest and less deductions made for life insurance premiums, as provided in Series B contracts in which paragraph 6 is effective.

8. Any contract holder desiring to receive back payments made after the beginning of the State Court proceedings may do so by filling out and mailing the enclosed application. No money can be returned to contract holders at this time which was paid in before April 4, 1941, the date upon which payments were first segregated and impounded under an order of the Insurance Commissioner of West Virginia. Contract holders will be either paid as creditors of the debtor in case of ultimate liquidation, or allowed to participate in a plan of reorganization of which they will be later notified. Loans on contracts cannot be made at this time, nor can cash surrender values be obtained.

9. To enter into correspondence with individual contract holders and creditors would involve a large expense to the trust, and would serve no very good purpose. You will be kept informed of your rights and of developments regarding a plan of reorganization.

Very truly yours, Central Trust Company, Trustee.
July 3, 1941.

[fol. 94] IN UNITED STATES DISTRICT COURT

[Title omitted]

ANSWER—Filed July 28, 1941

To the Honorable Ben Moore, Judge of the District Court of the United States for the Southern District of West Virginia:

Now comes the Banking Commission of Wisconsin by John E. Martin, Attorney General of the State of Wisconsin, and Rickard H. Lauritzen, Assistant Attorney General of the State of Wisconsin, said Banking Commission of Wisconsin having been permitted to intervene in this proceeding by order of the court herein, dated June 27, 1941, and for its answer to the petition of the debtor filed herein on June 6, 1941, alleges as follows:

First Defense

1. Answering paragraph I of debtor's petition, the Banking Commission of Wisconsin admits on information and belief that the debtor Fidelity Assurance Association was on June 6, 1941, when said petition was filed, a corporation duly organized and existing under the laws of the state of West Virginia; denies that said debtor had its principal assets within the southern district of West Virginia for a longer portion of the six months immediately preceding the filing of said petition than in any other judicial district; denies that said debtor on the date of said petition [fol. 95] owned assets of the value of $13,000,000.00, which it alleges in said petition were on the date of said petition situated in the city of Charlestown, West Virginia for more than six months immediately preceding the filing of said petition; denies that the Banking Commission of Wisconsin has information sufficient to form a belief that said debtor was incorporated under the laws of the state of West Virginia on the 26th day of April, 1911, as Fidelity Investment Loan Association and that its name was thereafter changed to Fidelity Investment Association, and that on or about December 31, 1940, its name was again changed to Fidelity Assurance Association, as alleged in said debtor's petition, and leaves the debtor to its proof thereon. Further answering paragraph I of debtor's petition, the Banking Commis-

sion of Wisconsin alleges that said debtor on the date of said petition was in a state of dissolution in the state of West Virginia, the original domicile of said corporation, and was and is presently without license to do business of any nature whatever in the state of West Virginia; that said debtor was on the date of filing said petition and is presently without license to do business of any nature in the state of Wisconsin, and that the Banking Commission of Wisconsin is informed and believes that said debtor was on the date of said petition and is presently without license to do business of any nature in any state whatever, and that said debtor was, prior to the filing of said petition, divested of substantially all its assets, its corporate charter, and its licenses and franchises to carry on the business which it had previously carried on, in any state whatsoever; and that said debtor does not exist as a corporation which may file a petition under Ch. X of the Bankruptcy Act.

[fol. 96] 2. Answering paragraph II of debtor's petition, the Banking Commission of Wisconsin denies that said debtor was on the date of said petition or is presently a corporation, as defined in the said Bankruptcy Act, which could be adjudged a bankrupt under said Act, and denies the allegations of said debtor in said petition that debtor is not an insurance corporation and alleges that if debtor had any corporate existence whatever on the date of filing of said petition such existence was as an insurance corporation chartered under the incorporation laws of the state of West Virginia as such and licensed under the insurance laws of the state of West Virginia as such, and that said debtor was therefore not authorized to file a *p-tition* under the provisions of Ch. X of the Bankruptcy Act. Further answering paragraph II of debtor's petition, the Banking Commission of Wisconsin alleges that said debtor was, in a number of the states in which it did business, licensed as an insurance company, in a number of other states was licensed as a building and loan association and was in the state of Wisconsin subject to statutory supervision and control in the same manner as a foreign building and loan association, and that by reason of the charter of said debtor, the nature of its business, and the nature of the licensing and control of said debtor in the states in which it operated, said debtor is entirely without the scope of the bankruptcy laws of the

United States, and without the scope of Ch. X of the Bankrupty Act.

3. Answering paragraph III of debtor's petition, the Banking Commission of Wisconsin admits the allegation therein contained that said debtor at the time of filing said petition was not licensed to sell investment or annuity contracts, and alleges that said debtor was, on the last date [fol. 97] prior to the filing of said petition, when it had any corporate existence, powers or license, licensed in the state of West Virginia, the state of its domicile, as a life insurance company, and as to each of the other allegations contained in said paragraph III of debtor's petition the Banking Commission of Wisconsin alleges that it does not have information sufficient to form a belief and leaves debtor to its proof thereon.

4. Answering paragraph IV of debtor's petition, the Banking Commission of Wisconsin alleges that it does not have information sufficient to form a belief as to the allegations therein contained and leaves debtor to its proof thereon.

5. Answering paragraph V of debtor's petition, the Banking Commission of Wisconsin alleges that as to the debtor having in existence and outstanding investment and annuity contracts having a total reserve liability of approximately $25,685,999.79 it does not have information sufficient to form a belief and leaves debtor to its proof thereon; denies that the debtor is the owner of assets of the value of approximately $23,000,000.00, approximately $13,000,000.00 of which are situate in the city of Charleston, West Virginia, and alleges that debtor, prior to the filing of said petition, had been divested by reason of the operation of state laws in the states in which debtor operated of substantially all its assets; denies that it has sufficient information to form a belief as to the allegations therein contained that the schedule attached to said petition, marked "Exhibit A", contains a full and true statement of all the assets and liabilities of said debtor, and as to the facts relative to said assets and liabilities leaves debtor to its proof thereon.

[fol. 98] 6. Answering paragraph VI of debtor's petition, the Banking Commission of Wisconsin admits the allega-

tions therein contained relative to the appointment of receivers for the property and assets of said debtor by the Circuit Court of Kanawha County, West Virginia, at the suit of Edgar B. Simms, Auditor of the State of West Virginia and ex officio Insurance Commissioner of the State of West Virginia, but denies that it has sufficient information to form a belief as to the present qualification and status of the receivers appointed by said state court, and leaves debtor to its proof thereon; further answering said paragraph VI of the debtor's petition the Banking Commission of Wisconsin denies that it has information sufficient to form a belief as to the allegations set forth in said paragraph relative to the appointment of independent receivers in the states of Indiana, Ohio, Illinois, Tennessee, Kentucky, Pennsylvania and other states, either as to the nature of said proceedings, the amount of assets involved in said proceedings, or the present status of said proceedings, and leaves debtor to its proof thereon; further answering said paragraph, the Banking Commission of Wisconsin alleges that on the 14th day of April, 1941, it took possession and control of the business and property of said debtor located in the state of Wisconsin and that on said date title to all of the assets, business and property of said debtor, located in the state of Wisconsin, was vested in the Banking Commission of Wisconsin, and that the Banking Commission of Wisconsin, from April 14, 1941 to June 6, 1941, at which latter date the petition of the debtor was filed, has proceeded to administer the assets of said debtor [fol. 99] located in the state of Wisconsin and to liquidate the same for the benefit of contract holders of said debtor residing in the state of Wisconsin, pursuant to the statutes of the state of Wisconsin in such cases made and provided.

7. Answering paragraph VII of debtor's petition, the Banking Commission of Wisconsin admits that debtor had outstanding certain investment and annuity contracts, but as to the allegation that the reserve liabilities totalled approximately $25,000,000.00, denies that it has information sufficient to form a belief and leaves debtor to its proof thereon; admits that in these contracts the debtor agreed to pay certain interest accumulations, but denies that it has information sufficient to form a belief as to the amount of said interest accumulations and leaves debtor to its

proof thereon; denies that it has information sufficient to form a belief as to whether the decrease in interest rates in recent years has made it impossible for debtor to invest its funds in conformance with the West Virginia law and to earn the interest requirements as set forth in its said outstanding contracts, and leaves debtor to its proof thereon; admits that prior to the time of the filing of said petition the debtor was suffering an annual loss and that this loss will continue and increase, but denies that it has information sufficient to form a belief as to the precise amount of annual loss or whether such loss could be avoided by an increase in earnings of the securities of the debtor, and leaves debtor to its proof thereon; admits that the debtor has been and will be unable to meet its obligations as they mature, but as to whether the reasons for its inability to meet said obligations are the reasons set forth by debtor in said paragraph VII the Banking Commission of Wisconsin [fol. 100] denies that it has information sufficient to form a belief and leaves debtor to its proof thereon and alleges that such inability to meet its obligations in a large measure resulted from mismanagement and dissipation of its assets on the part of said debtor and its stockholders, officers and directors and its failure to comply with state laws designed to safeguard the interests of the purchasers of said debtor's contracts; denies that if the rights of the outstanding contract holders of debtor are modified as alleged in said petition the debtor will be able to meet its reserve requirements and will be able to comply with the Investment Company Act of 1940 and will be able to resume the operation of its business, and specifically alleges that in the state of Wisconsin said debtor would not under such circumstances be enabled to resume its business, and that said debtor has lost its license to do business in the state of Wisconsin and that said debtor will be wholly unable to modify the contracts of said debtor held by residents of the state of Wisconsin, said contract holders being entitled to look to the deposits made by said debtor in the state of Wisconsin in accordance with Wisconsin law for the payment of the amounts due on said contracts without modification thereof and further alleges on information and belief that the debtor will for similar reasons be wholly unable to resume business in any state whatsoever at any time; admits that each of the outstanding contracts of debtor is secured by certain funds on deposit with the Treasurer of the state of

West Virginia and with the officials and departments of other states where the securities of debtor were sold, but as to the nature of said funds and the security afforded thereby, except as regards the state of Wisconsin, alleges that it does not have information sufficient to form a belief and leaves debtor to its proof thereon; admits that debtor [fol. 101] could obtain no relief in this proceeding unless the rights of all contract holders were modified, but specifically denies the right of debtor or any other person or agency to modify said contracts including those held by residents of Wisconsin, and denies that debtor is entitled to any relief under Ch. X of the Bankruptcy Act and as to whether debtor by reason of the facts alleged in paragraph VII of said petition could not obtain adequate relief under Ch. XI of the Bankruptcy Act; alleges that it does not have information sufficient to form a belief and leaves debtor to its proof thereon.

8. Answering paragraph VIII of debtor's petition, the Banking Commission of Wisconsin admits on information and belief that no plan of reorganization has yet been formulated, but as to debtor's knowledge of any plan of reorganization, readjustment or liquidation affecting the property of the corporation pending either in connection with or without any judicial proceeding except receiverships created in West Virginia and other states, some of which are threatening to sell the assets now in their possession as alleged in said petition, the Banking Commission of Wisconsin denies that it has information sufficient to form a belief and leaves debtor to its proof thereon.

9. Answering paragraph IX of debtor's petition, the Banking Commission of Wisconsin denies that the debtor is a corporation which might lawfully form a desire to effect a plan of reorganization under Ch. X of the Bankruptcy Act, and therefore denies the same.

[fol. 102] 10. Answering paragraph X of debtor's petition, the Banking Commission of Wisconsin denies that it has information sufficient to form a belief as to the allegations therein contained and leaves debtor to its proof thereon, and specifically denies that any action on the part of the Board of Directors of debtors, or any other corporate action on the part of said debtor, could lawfully authorize the filing of a petition by said debtor under Ch. X of the Bankruptcy Act.

Second Defense

Further answering the petition of the debtor herein, and in addition to its admissions and denials of the allegations thereof as aforesaid, the Banking Commission of Wisconsin alleges:

1. That said debtor's petition filed June 6, 1941, was not filed in good faith as required by Ch. X of the Bankruptcy Act in that among other things it is wholly unreasonable to expect that a plan of reorganization can be effected herein and in that prior proceedings are pending in the courts of the state of Wisconsin and in the courts of other states in which proceedings the interests of Wisconsin creditors and creditors resident in other states would be best subserved.

2. That the stockholders of debtor have no equity or interest whatever remaining in the business, property or assets of said debtor, the contract holders of said debtor constituting the only remaining interest in the business, property and assets of said debtor, and said stockholders have no legitimate interest whatever to be served by [fol. 103] the maintenance of this proceeding and that the maintenance of this proceeding can result only to the detriment of the contract holders of debtor located in Wisconsin and elsewhere.

3. That the contract holders of said debtor located in Wisconsin are presently protected to the full extent of the value of the contracts held by them by funds deposited in Wisconsin by said debtor, title to which funds is now in the Banking Commission of Wisconsin and which funds are ready for distribution to said Wisconsin contract holders.

4. That, as the Banking Commission of Wisconsin is informed and believes, funds are also on deposit and held for distribution to contract holders in the state of West *of West* Virginia, and in other states, which will be readily available to all of said contract holders and no possible interest of said contract holders can be served by the continuance of this proceeding.

5. That the petition herein was filed at the instance of persons who are in the position of mere adventurers and who have no interest whatever in the business, property or assets of said debtor and the filing of said petition consti-

tutes an attempt to harass, hinder and delay the efforts of contract holders to realize the value of their contracts according to their rights under laws expressly adapted to such purpose, is in derogation of the very laws under which debtor operated and obtained its business and revenues during its business career, and is a gross misuse and perversion of the jurisdiction granted to the courts by Ch. X of the Bankruptcy Act.

6. That the filing of the debtor's petition has necessarily resulted in a contest as to the jurisdiction of the court herein, which contest was inevitable by reason of the duties [fol. 104] of the Banking Commission of Wisconsin and other state authorities to safeguard the interests of contract holders resident in Wisconsin and other states under state laws, and that the continuance of these proceedings in view of such contest will necessarily result in long and costly litigation and thousands of contract holders in the state of Wisconsin and elsewhere will have to await the payment of their just claims pending the outcome of such litigation and the outcome of these proceedings, by reason of which the contract holders located in Wisconsin and elsewhere will suffer irreparable loss, all of which was well known to the debtor at the time of filing said petition.

7. That to the knowledge of the Banking Commission of Wisconsin the contract holders of said debtor resident in Wisconsin are desirous that the funds deposited by debtor in Wisconsin in trust for the benefit and security of Wisconsin contract holders should be liquidated and paid out and that a large number of contract holders have urgently requested that these funds be so paid out to them, and, in view of the history of said debtor in Wisconsin and its failure to meet its obligations, said contract holders are no longer willing to carry their contracts with said debtor either as presently constituted or upon any proposed reorganization, and the Banking Commission of Wisconsin is informed and verily believes that said contract holders will not consent to any plan of reorganization whatever involving said debtor. That the Banking Commission of Wisconsin is informed and believes that a similar situation exists with respect to contract holders of debtor residing in other states, and that for such reasons it would be wholly impossible to effect a plan of reorganization herein.

[fol. 105] 8. That an examination of the terms of the various contracts which debtor has outstanding which include provisions relative to cash value, paid up contract value, options, reserve funds, maturity and retirement funds, surplus participation, cash commuted value, insurance protection features, and many other diverse and complex provisions illustrates that insurmountable difficulties would be presented in attempting to modify all of the various classes of contracts outstanding and to secure the consent of the requisite number of contract holders thereof, and demonstrates conclusively that a reorganization of the debtor is not feasible.

9. That although all of the facts alleged in this answer were well known to the debtor at the time said petition was filed and said debtor has for a period of some years been well aware that it would be unable to meet its contract obligations, yet said debtor has wholly failed to file or suggest any plan of reorganization up to the present time and has given no indication whatever as to when such a plan may be forthcoming, and that the failure of debtor in this respect under the circumstances existent demonstrates conclusively its lack of good faith in the filing of said petition.

Wherefore, the Banking Commission of Wisconsin prays that the petition of said debtor be dismissed.

Banking Commission of Wisconsin, by Robert K. Henry, Commissioner; John E. Martin, Attorney General, State of Wisconsin; Richard H. Lauritzen, Assistant Attorney General, State of Wisconsin, Attorneys for the Banking Commission of Wisconsin.

Dated this 25th day of July, 1941.

[fol. 106] *Duly sworn to by Robert K. Henry. Jurat omitted in printing.*

[fol. 107] IN UNITED STATES DISTRICT COURT

[Title omitted]

ORDER—August 1, 1941

This day came the Central Trust Company, Trustee herein, and filed its petition, requesting that its authority

heretofore granted herein by order of June 7, 1941, authorizing the said Trustee to employ one James R. Fleming, Attorney at Law, for special services during the period of the administration of this trust, be countermanded.

And the Court having examined the said petition and being fully advised in the premises now grants the prayer of said petition and hereby revokes and countermands the authority heretofore granted the Trustee to employ the said James R. Fleming for the performance of such special services as required by the Trustee in the administration of this trust.

Dated this 1st day of August, 1941.

Ben Moore, U. S. D. J.

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(The Petition, referred to in the foregoing order, is in the words and figures as follows):

[fols. 108-110] IN UNITED STATES DISTRICT COURT

[Title omitted]

PETITION FOR AUTHORITY TO DISPENSE WITH SERVICES OF JAMES R. FLEMING—Filed August 1, 1941

To the Honorable Ben Moore, Judge of Said Court:

Now comes the Central Trust Company, Trustee herein, and respectfully shows the Court that under an order heretofore entered herein on June 7, 1941, your Trustee was authorized and empowered by the Court, pursuant to Section 157 of Chapter 10 of the Federal Bankruptcy Act, to employ one James R. Fleming, Attorney at Law, for special services for the purpose of assisting your Trustee in marshalling the assets of the debtor and for the purpose of assisting your Trustee in the development and formulation of a plan of reorganization for the affairs of the debtor. Your Trustee would now respectfully represent unto the Court that it does not deem it necessary to so engage the services of the said James R. Fleming.

Wherefore, your petitioner prays that an order be entered by the Court countermanding the authority of your Trustee to employ the said James R. Fleming as aforesaid.

Central Trust Company, Trustee, by A. A. Payne,
Vice President and Trust Officer.

[fol. 111] IN UNITED STATES DISTRICT COURT

[Title omitted]

ANSWER AND CONTROVERSION OF EDGAR B. SIMS, AUDITOR OF THE STATE OF WEST VIRGINIA, AND EX-OFFICIO INSURANCE COMMISSIONER OF THE STATE OF WEST VIRGINIA—Filed August 4, 1941

*To the Honorable Ben Moore, Judge of the District Court of the United States, for the Southern District of West Virginia:*

The respondent, Edgar B. Sims, who is the duly elected, qualified and acting Auditor of the State of West Virginia, and ex-officio is the Insurance Commissioner of the State of West Virginia, and who was given leave to intervene in this cause and file such answers or other pertinent or necessary pleadings as he might deem appropriate by order entered in this cause on the 13th day of June, 1941, for answer to the petition of the debtor filed herein, says:

[fol. 112] I

Respondent admits that the debtor, Fidelity Assurance Association, is a corporation duly organized and existing under the laws of the State of West Virginia, but denies that it has had its principal assets within the Southern District of West Virginia for a longer portion of the six months immediately preceding the filing of the petition than in any other Judicial District, and denies that its principal assets of the value of approximately $13,000,000.00 were situate in the City of Charleston, West Virginia, in said Southern District, for more than six months immediately preceding the filing of the petition. Respondent avers that the assets referred to in the debtor's petition as being the principal assets of the debtor and as having a value of approximately $13,000,000.00, consist of securities deposited by the debtor with the State of West Virginia in accordance with the provisions of Chapter 33, Article 9, Section 3 and Chapter 12, Article 5, as amended, of the Code of West Virginia; that the term, "principal assets," as used in Section 128 of the Bankruptcy Act, means assets which are capable of being taken into possession by the Trustee appointed for the debtor and susceptible of administration by said

Trustee; that said principal assets referred to are not capable of being taken into possession by said Trustee nor susceptible of administration by it, and, therefore, are not "principal assets" located in the Southern District of West Virginia for the purposes of the Bankruptcy Act. Respondent avers that the debtor has no other assets of substantial value located in the above named Judicial District. Respondent avers that the principal place of business of the debtor and the place where it has had its principal assets for the sixth month preceding the filing of the petition is in the City of Wheeling, West Virginia, in the Northern District of West Virginia.

[fol. 113] Respondent admits that the debtor was incorporated under the laws of the State of West Virginia on the 26th day of April, 1911, as Fidelity Loan Association, that its name was thereafter changed to Fidelity Investment Association, and that on or about December 31, 1940, its corporate name was again changed to Fidelity Assurance Association.

II

Respondent admits that the debtor is a corporation which could be adjudged a bankrupt under the Federal Bankruptcy Act, and is not a municipal insurance or banking corporation, or building and loan association, and is not a railroad corporation authorized to file a petition under the provisions of the Bankruptcy Act.

III

Respondent admits all of the allegations of Paragraph III of the petition, except such portion thereof as infers that the Investment Company Act of 1940 made it impossible for the debtor to comply with the provisions of said Act by reason of having "increased the reserve requirements on the part of debtor to contractholders," but avers that the debtor could not comply with the provisions of Section 28 of said Act, requiring any registered face amount certificate company, before it could issue or sell any face amount certificates or collect or accept any payment on any such certificate issued by such company on and after January 1, 1941, to have outstanding a capital stock worth on a fair valuation of assets, not less than $50,000.00, and to maintain at all times minimum certificate reserves on all its outstanding face amount cer-

tificates in an aggregate amount calculated to be sufficient in amount, as and when accumulated, at a rate *not* to exceed three and one-half percentum per annum, compounded annually, to provide the minimum maturity or [fol. 114] face amount of the certificate when due, and avers that there were other requirements of the said Investment Company Act of 1940 which debtor could not and cannot comply with.

IV

Respondent admits all of the allegations of Paragraph IV of the petition stating the capitalization of the debtor, but denies any inference which may be drawn therefrom to the effect that said capital constitutes any fund or security in the commonly accepted sense of a capital account, or that it is represented by any assets in any way equivalent to the total par amount of said stock available as a capital fund after payment of all claims of creditors, but avers that the payment of all claims of the creditors would entirely wipe out said capital account and the assets carried on the books of the debtor to maintain the same.

V

Respondent denies that the debtor has in existence outstanding investment and annuity contracts having a total reserve liability of approximately $25,685,999.79, that it is the owner of assets of the value of approximately $23,000,000.00, of which $13,000,000.00 thereof is situate in the City of Charleston in the Southern District of West Virginia; and denies that the schedule filed with the petition as Exhibit A contains a full and true statement of all the assets and liabilities of the debtor as of the date of the filing of the petition, but avers that as of April 11, 1941, the total reserve liability and the cash liability of all debtor's outstanding investment and annuity contracts were $26,932.488.31 and $26,186,505.62, respectively. Respondent further avers that among other failures, such schedule does not reflect as a fixed liability an indebtedness [fol. 115] of $750,000.00 owed by the debtor as endorser on a note of National Sales Agency, Inc., held by three of the debtor's sponsored contract reserve funds, nor does it disclose that any claim against said National Sales Agency, Inc., on said note is utterly worthless.

VI

Respondent admits that on April 11, 1941, he filed his petition in Chancery in the Circuit Court of Kanawha County, West Virginia, asking, among other things, for the appointment of a Receiver or Receivers for the property and assets of the debtor, but avers that under the statutes of the State of West Virginia in such cases made and provided, he, as Auditor and ex-officio Insurance Commissioner of the State of West Virginia, has the same authority over the debtor as over an insurance company, and under the facts and circumstances disclosed in his bill, he was required, with the aid and upon filing of a bill in said Court, to administer the assets of said debtor as an insolvent, and to take possession of its property in the State of West Virginia and distribute its assets among those entitled thereto according to their respective rights, and that in performing the duties imposed upon him by statute with respect to said debtor, he had the right to the aid, counsel, advice and instructions of said Court; that in addition to asking for the appointment of a Receiver or Receivers for the property and assets of the debtor, he asked for the administration of the assets of said debtor as an insolvent, the taking of possession of such property of said debtor in said State and the distribution of its assets among those entitled thereto or the rehabilitation and reorganization of said debtor, and asked for the entry of the proper orders and decrees necessary or needful to aid, guide and instruct him in the performance of the various duties imposed upon him by the statutes of the State of [fol. 116] West Virginia, particularly Chapter 33, Article 9, Section 10, of the Code of West Virginia, relating to control and disposal of securities deposited by the debtor with the State of West Virginia in trust for the benefit of its contractholders.

Respondent admits that said Court in said proceedings appointed H. Isaiah Smith and Ross B. Thomas as Receivers for the assets of the property of the debtor, but denies that said Receivers were appointed Receivers for all of the property and assets of the debtor situate in the State of West Virginia in so far as the same would be inclusive of the securities of the debtor deposited as aforesaid with the State of West Virginia, and denies that said

Receivers are Receivers for, or have taken into their possession, such securities deposited with the State of West Virginia.

Respondent admits that Receivers were appointed in the States of Indiana, Ohio, Illinois, Wisconsin, Tennessee, Kentucky and Pennsylvania, and various other states, for the assets and property of the debtor situate in those states, and that said Receivers have taken charge and are holding such assets so situate in each of the said respective states, but denies that the value of the assets and property of the debtor situate in said states has the approximate value of $10,000,000.00.

VII

Respondent admits that the debtor has outstanding investment and annuity contracts with certain reserve liabilities, but denies that the total amount thereof is approximately $25,000,000.00, but avers and charges that said reserve liability on April 11, 1941, was $26,932,488.31. Respondent admits that debtor agreed to pay the interest accumulations or improvements specified in debtor's petition; that the decrease in interest rates in recent years [fol. 117] obtainable from securities acceptable for deposit under West Virginia Law has been insufficient to earn the interest requirements required by its outstanding contracts, and that by said deficiency in earnings of interest, the debtor is now suffering an annual loss of approximately $250.000.00, and that said loss will continue and probably increase unless the earnings on sound securities should substantially increase over the present rate of interest.

Respondent admits that the debtor was unable to meet its obligations as they matured, but denies that debtor will be able to meet its obligations as they mature if "the rights of its contractholders are modified so that the earnings received on securities and assets owned by debtor will be sufficient in amount to meet the requirements under its outstanding contracts"; and denies that "if the rights of its outstanding contractholders are modified to this extent, debtor will be able to meet its reserve requirements and will be able to comply with the Investment Company Act of 1940, and will be enabled to resume the operation of its business." Respondent charges that the debtor's license from the State of West Virginia to engage in the

business of issuing and selling investment or annuity contracts has expired and has not been renewed; that before debtor could resume the operation of its business it would have to obtain new licenses from the State of West Virginia and from the various other states in which it operates; that the financial condition of the debtor was such that the respondent as Insurance Commissioner was required to administer the affairs of the debtor as an insolvent, and the statutes of the State of West Virginia in such cases made and provided require respondent to keep the deposit made with the State of West Virginia under his authority and control until the total liability of all [fol. 118] the contracts, certificates or annuity bonds or contracts issued by the debtor in this state is redeemed or settled. Respondent charges that there can be no resumption of the operation of the business by the debtor until the Insurance Commissioner of the State of West Virginia has issued it a license to do business in accordance with the statute and until the total liability of all such contracts issued by the debtor in this State is redeemed or settled.

VIII

Respondent has no knowledge of whether any plan of reorganization of the debtor was being formulated other than to the extent that a plan was in process of being formulated by the Receivers appointed by the Circuit Court of Kanawha County, which plan would have involved in all cases voluntary action on the part of each of the contractholders of the debtor with respect to any adjustment or modification of their individual rights and privileges.

IX

Respondent denies that it is the desire of the debtor that a plan of reorganization be effected under the provisions of Chapter X of the Bankruptcy Act, and that a Trustee be appointed for the purpose of formulating and presenting a plan of reorganization for debtor under the provisions of said chapter, but charges, on information and belief, that debtor filed its petition for the express and primary purpose of attempting to oust him, as Insurance Commissioner of the State of West Virginia, of the jurisdiction over the debtor and its administration

as an insolvent given him by the statutes of the State of West Virginia in such cases made and provided. Respondent avers that the capital accounts of the debtor are impaired many times the total amount thereof; that it had been his unyielding decision and policy to formulate no plan of rehabilitation or reorganization, nor recognize [fol. 119] nor approve any plan of reorganization or rehabilitation submitted by others which in any way would recognize, treat with or give effect to any pretended equity remaining in the capital accounts for the stockholders of the debtor, a policy which he had many times unequivocably stated, and which was well known to all of the members of the Board of Directors who caused this proceeding to be instituted. Respondent charges that with their intimate knowledge of debtor's financial condition, such directors must be presumed to have known that no plan of reorganization of the debtor could be effected under Chapter X of the Bankruptcy Act which would give any recognition to their position as stockholders of the debtor, and, therefore, further charges that this proceeding was instituted in bad faith by such members of the Board of Directors of the debtor for the purpose of ousting the jurisdiction of respondent and the State Court Receivers, through liquidation in a bankruptcy proceeding, but inasmuch as a bankruptcy court, under Chapters I to VIII of the Bankruptcy Act, would have no jurisdiction over the assets of the debtor deposited with various state authorities, a voluntary petition in bankruptcy would be ineffective to accomplish their purpose without there first having been instituted an intermediate proceeding under Chapter X of the Bankruptcy Act, whereby the debtor and its directors hoped to be able to vest in a trustee in reorganization proceedings possession and title to such deposited securities, to be later transferred to a trustee in bankruptcy when it would become evident that no plan of reorganization under Chapter X could be feasible or adopted or confirmed by the court, necessitating a dismissal of proceedings or a transfer to bankruptcy.

X

Respondent admits that certain individuals purporting to be directors of the debtor congregated in the City of Pitts- [fol. 120] burgh, Pennsylvania, on the 3rd day of June,

1941, and held what was purported to be a special meeting of the Board of Directors of the debtor, but respondent denies that a special meeting of the Board of Directors of the debtor was legally and validly held on the 3rd day of June, 1941, or that a copy of said resolution filed with debtor's petition as Exhibit B is a copy of a resolution duly adopted by a meeting of the Board of Directors of said debtor duly called, convened and held, for the reasons hereinafter more fully set forth in the controversion portion of this answer.

As to all of the allegations of the debtor's petition hereinbefore denied, this respondent demands strict proof.

And Now, having fully answered the petition of the debtor filed in this cause, the respondent, by way of controversion to said answer, would show the following:

XI

Respondent avers that the petition in this cause was neither properly and legally filed, nor was it filed in good faith because it was not validly and legally authorized by a proper and legal meeting of the Board of Directors of the debtor, and in support thereof says:

1. The purported meeting of the Board of Directors of the debtor, held on the 3rd day of June, 1941, was held in the City of Pittsburgh, Pennsylvania, pursuant to notice sent to all of the directors. The by-laws of the debtor do not provide any place for the holding of regular or special meetings of the Board of Directors, nor to this respondent's knowledge had the Board of Directors by resolution provided the City of Pittsburgh as a place where regular or special meetings of the Board of Directors could be held. Respondent charges that in the absence of provisions of the [fol. 121] by-laws or resolution of the Board of Directors fixing a place for the holding of meetings of the Board of Directors, such meetings must be held at the principal office of the corporation, which, in the case of the debtor, is in the City of Wheeling, West Virginia, and this respondent, therefore, avers that any meeting purporting to be a meeting of the Board of Directors of the debtor held on the 3rd day of June, 1941, in the City of Pittsburgh, Pennsylvania, was invalid as such and all action taken thereat null and void and of no legal effect whatever.

2. The by-laws of the debtor in effect on June 3, 1941, provided that the number of directors should consist of not more than fourteen (14) stockholders, any seven (7) of whom should constitute a quorum. At the last previous annual meeting of the stockholders of the debtor, held on February 21, 1941, fourteen (14) stockholders were elected to the Board of Directors, of whom four, namely, Arthur B. Koontz, Wheeler C. Bachman, Walter T. Grosscup and Tom B. Foulk, had either refused to serve as such or had resigned prior to the purported meeting held June 3, 1941, and two directors so elected, namely, Edwin R. Palmer and S. J. Gilfillan, had not qualified or indicated whether they would accept the directorship to which they were elected, thus leaving the Board constituted on June 3, 1941, at eight members. On information and belief, at the purported meeting held on said date, there were present the following persons, who had been elected directors of the debtor: John Marshall, Sr., John Marshall, Jr., A. L. King, F. H. Pulfer, H. E. Reed and A. G. Messick, six in number. There were absent: F. S. Risley and C. E. Smith. The six persons present did not constitute a quorum of the Board of Directors for the transaction of business as provided by the by-laws, such number required being seven, and respondent avers on information and belief that in order to provide a quorum for the adoption of the resolution [fol. 122] authorizing the institution of this proceeding, one James R. Fleming of Ft. Wayne, Indiana, who was not a stockholder of the debtor or a director thereof, but who was nevertheless present at said meeting, and who is the same James R. Fleming who filed the debtor's petition in this cause as counsel, suggested that the secretary of the corporation, F. J. McNulty, who was present at the meeting, become and be elected a member of said Board of Directors, but Mr. McNulty declined so to serve; that thereupon the said James R. Fleming stated in effect that he deemed it preferable for him (James R. Fleming), in the light of future matters, not to become a member of said Board or serve thereon, but that as an emergency confronted them, and to make a quorum, he would consent to become a member of the Board of Directors at the meeting thereof held at Pittsburgh on June 3, 1941, and would resign at the close of the meeting; that thereupon the said James R. Fleming was elected by the six

directors in attendance at said meeting to be a member of the Board of Directors for the purpose of providing a quorum for the transaction of the business which was to come before the meeting, namely, the authorization of the filing of the petition in this proceeding, and that after the adoption of the resolution filed as Exhibit B to the debtor's petition, and as the last item of business of said special meeting, the said James R. Fleming resigned as director. The by-laws provide that the number of directors shall consist of not more than fourteen *stockholders*, and neither at the time of his election as director, nor during his service in such capacity, nor at any time subsequent thereto, was the said James R. Fleming the holder of any shares of stock of the debtor, and was ineligible in any case to be elected as a member of the Board of Directors. Respondent charges that as a matter of law the election of the said James R. Fleming as a member of the Board of Directors of the debtor was a nullity not [fol. 123] only for the reason that he was ineligible by reason of not being a stockholder of the debtor, but particularly because the circumstances of his election, namely, the expressed reluctance to serve except as an emergency measure for the accomplishment of a single specified purpose, coupled with his intention of resigning at the close of the meeting, which was expressed prior to his election, and as a condition thereof, and his service solely in connection with the authorization of the institution of this proceeding, which he later was to institute as counsel, rendered his election a fraud in law. Respondent, therefore, charges that the election of said James R. Fleming as a director was a nullity, and that at no time at said meeting of June 8, 1941, was a quorum, as provided by the by-laws of the debtor, present and acting.

3. Section 9A of the Investment Company Act of 1940 makes ineligible certain persons to serve as an officer or director of a registered investment company by declaring that it shall be unlawful for any person to serve or act in the capacity of director who, by reason of any misconduct, is permanently or temporarily enjoined by order, judgment or decree of any court of competent jurisdiction from acting as an underwriter, broker, dealer or investment adviser, or as an affiliated person, salesman or employee of any investment company, bank or insurance

company, or from engaging in or continuing any conduct or practice in connection with any such activity, or in connection with the purpose or sale of any security. In December, 1938, the Securities and Exchange Commission filed a civil action against the debtor in the United States District Court for the Eastern District of Michigan, Southern Division, in which it sought an injunction against the violation of Section 17 of the Securities Act of 1933 (15 U. S. C. 77 Q). The defendant filed an answer which substantially admitted the basic facts alleged in the complaint, but denied the legal effect sought to be drawn there- [fol. 124] from by the Commission. Without going to trial on the issues, the debtor consented to the entry of a final judgment, admitting the jurisdiction of the court for the purposes of the actions, but without admitting the allegations of the complaint, and denying past derelictions. The final judgment, without containing any finding that any particular acts or practices were fraudulent, nor enjoining any particular conduct as such, enjoins the defendant (debtor herein) its officers, directors, agents, employees and representatives in the sale of its contracts by use of any means or instruments of transportation or communication in interstate commerce, or by use of the mails, directly or indirectly, from doing certain acts and things and engaging in certain activities.

All of the directors present at the meeting in Pittsburgh on June 3, 1941, with the exception of A. G. Messick, were officers or directors, or both, of the debtor at the time of the entry of the aforesaid final judgment, and as such had been enjoined from engaging in or continuing certain conduct or practice in connection with the sale of the debtor's contracts. Such directors, who were so ineligible in January or February of this year, filed with the Securities and Exchange Commission applications for exemption from ineligiblity imposed by Section 9A of the Investment Company Act of 1940, and this respondent, on information and belief, avers that thereafter the Securities and Exchange Commission granted temporary exemption upon such application, but almost immediately thereafter and prior to June 3, 1941, revoked such temporary exemption, and, therefore, this respondent charges that all of the directors purporting to act at said meeting of June 3, 1941, with the exception of A. G.

Messick, were ineligible to serve as directors of the debtor under the provisions of Section 9A of the Investment Company Act of 1940, to which the debtor, its officers and directors are subject, and that by reason thereof all action [fol. 125] taken and resolutions adopted at said purported meeting are null and void and of no legal effect whatever.

XII

Respondent charges that the petition filed by the debtor herein was not filed in good faith as required by Section 141 of the Bankruptcy Act, and in the nature of specifications therefor says:

1. The petition was not filed in good faith by reason of the circumstances alleged in Paragraph IX of this answer, relating to the purpose for which this respondent charges the petition was filed.

2. The petition was not filed in good faith by reason of the circumstances set forth in Paragraph XI of this answer, and particularly in subparagraph (2) thereof, the latter relating to the manner and circumstances surrounding the election of James R. Fleming to the Board of Directors of the debtor, his action taken as such director, and his subsequent resignation at the close of the meeting in which he was elected, all taken immediately prior to and in contemplation of the filing of the petition.

3. The petition was not filed in good faith because it alleges a desire not only to effect a reorganization (denied by this respondent), but on its face, discloses a desire to effect such reorganization in such a manner as would be of benefit to the stockholders and directors of the debtor at the expense of its contractholders or creditors when it was well known to the directors authorizing the filing of the petition that there was no equity remaining for the stockholders which could lawfully be treated with in any reorganization under the provisions of Chapter X of the Bankruptcy Act. Specifically, the debtor's petition states in Paragraph IX thereof that it is the desire of the debtor that a plan of reorganization be effected under the pro- [fol. 126] visions of Chapter X of the Bankruptcy Act, and that a trustee be appointed to formulate and present such plan of reorganization while in Paragraph

VII of its petition the debtor states that it will be unable to meet its obligations as they mature "unless the rights of its contractholders are modified so that the earnings received on securities and assets owned by debtor will be sufficient in amount to meet the requirements under its outstanding contracts; and if the rights of its outstanding contractholders are modified to this extent, debtor will be able to meet its reserve requirements and will be able to comply with the Investment Company Act of 1940, and will be enabled to resume the operation of its business." Respondent charges that it is apparent from the foregoing allegations of the debtor's petition that if indeed it seeks any reorganization, which is denied by this respondent, it seeks a reorganization whereby the interests of the stockholders will be preserved or benefited, and whereby it will be enabled to resume the operation of its business for the benefit of its stockholders and under their continued ownership, at the expense of the contractholders or creditors by modifying the rights of said contractholders (so that the earnings received on securities and assets owned by debtor will be sufficient in amount to meet the requirements under its outstanding contracts."

4. This respondent is advised that it is proper in determining the good faith and proper motives or absence thereof in connection with the filing of a petition such as the debtor has filed herein to look to the acts of the persons instigating the proceedings taken at and immediately before and after the filing of the petition. Respondent avers that the Chairman of the Board of Directors of the debtor was and is A. G. Messick of Chicago, Illinois; that said Messick is not and never was the holder of any sub- [fol. 127] stantial amount of stock of the debtor; that said Messick became involved in the affairs of the debtor in the early part of the year 1940 under a contract whereby it was contemplated that a new corporation would be formed to take over the assets, liabilities and business of the debtor; that Messick and associates would provide the new corporation with a paid-in capital of at least one-half million dollars, for which they would receive eighty per cent of the stock and the balance, or twenty per cent thereof, would be distributed to the then stockholders of the debtor; that said contract was in effect a plan of recapitalization of the debtor; and was dependent for its consummation upon a number of

conditions safeguarding Messick and his associates; that pending the consummation of the plan, and during the period when a majority of the stock of the debtor had become vested in John Marshall, Sr., Trustee, pursuant to said agreement, said Messick was elected a director and eventually Chairman of the Board of Directors of the debtor; that after said plan of recapitalization had failed of consummation, and he had not provided the half million dollars of capital or any sum of money for the debtor, and no longer had any proper interest in its affairs, he continued to hold such offices and to exercise control and dominance over the debtor, although this respondent, as Insurance Commissioner of the State of West Virginia, did then and on several occasions thereafter demand his (Messick's) resignation and removal and the severance of all of his connections with debtor. This respondent charges on information and belief that the James R. Fleming, heretofore mentioned in this answer, had long been a close associate of the said A. G. Messick. This respondent further charges on information and belief that at the instigation of said A. G. Messick, and with the aid of James R. Fleming, the Board of Directors held a purported meeting thereof on the 3rd day of June, 1941, and authorized the filing of the debtor's petition; that in [fol. 128] the afternoon of June 6, 1941, the debtor's petition was filed in this Court, and that upon the filing thereof the Court entered an order approving the petition and appointing Central Trust Company of Charleston, West Virginia, Trustee for the debtor. On the following morning, June 7, 1941, said Trustee qualified as such by accepting the trust and giving bond. Immediately thereafter, on the same morning it selected and recommended its general counsel to aid and assist it in the administration of the trust; to which this respondent has no objection, but charges that at the same time it filed a petition in this cause for authority to employ the said James R. Fleming and A. G. Messick "for the purpose of assisting your Trustee in marshaling the assets of said debtor which are now situate in divers states outside the territorial limits of the State of West Virginia, and also for the purpose of assisting the Trustee in the development and formation of a plan of reorganization for the affairs of debtor in this proceeding * * * and that this

authority is requested under Section 157 of Chapter X of the Federal Bankruptcy Act." Whereupon, the Court entered an order authorizing the employment of James R. Fleming and A. G. Messick as requested.

This respondent charges that under Section 157 of the Bankruptcy Act, an attorney appointed to represent a Trustee shall be a disinterested person except that for any specified purposes *other that to represent a Trustee in conducting the proceeding* under Chapter X, the Trustee may, with the approval of the Judge, employ an attorney who is not disinterested. Section 157 of the Bankruptcy Act declares that a person shall not be deemed disinterested if he is or was within two years prior to the date of the filing of the petition a director or an attorney for the debtor, or for any reason has an interest materially adverse to the interest of any class of creditors or stockholders. This respondent charges that the [fol. 129] purposes for which the said James R. Fleming and A. G. Messick were employed, as disclosed by the petition of the Trustee, were clearly matters in aid of the Trustee in conducting the proceeding, especially in so far as their services would be used in the preparation and formulation of a plan of reorganization, a duty exclusively imposed upon a disinterested trustee, and instead of being authorized by Section 157 of the Bankruptcy Act was specifically prohibited by Section 157 of the Bankruptcy Act.

This respondent charges that regardless of the propriety of the employment of said James R. Fleming and A. G. Messick to assist the Trustee, their projection of themselves into this proceeding, as special counsel or employees to assist the Trustee in matters peculiarly and strictly within the proceeding, on the day after the filing of the petition and coincident with the qualification of the Trustee and the giving of its bond, is a badge of bad faith upon the part of said Fleming and Messick, and, therefore, upon the part of the debtor, apparent on the record of this proceeding.

XIII

The respondent charges that the petition was not filed in good faith within the provisions of Section 146(3) of the Bankruptcy Act in that it is unreasonable to expect that a plan of reorganization can be effected.

This respondent avers that suited as the provisions of Chapter X of the Bankruptcy Act may be when applied to the reorganization of ordinary business corporations, its provisions do not meet the needs of the debtor nor lend themselves to a ready application to the facts and principles involved in connection with any reorganization of the debtor. The respondent charges that the debtor is liable to contractholders residing in every state of the [fol. 130] United States and in some foreign countries; that in twenty of said states the debtor was required to obtain a license from a specified state authority, usually the Insurance Commissioner, the Banking Commissioner or the Securities Commissioner; that in fifteen of said states the debtor was required, or has in the past been required, to maintain deposits with specified state authorities of securities for the protection of resident contractholders within the state. The respondent charges that in each of the fifteen states in which the debtor has deposits, the same are held in trust or under a lien for the benefit of resident contractholders. Respondent avers that at the outset there are thus fifteen classes of creditors, differing in the amount of securities pledged for the benefit of their respective classes, and differing in the percentage of coverage afforded by said deposited securities to the total liability within the state.

Respondent further avers that the debtor has issued seven separate and distinct series of contracts, each providing that there shall be segregated and held in trust for the benefit of all the contractholders of that series, securities of the kind prescribed by the laws of the State of West Virginia, and further avers that in the case of three of said series of contracts debtor is, by the terms of said contract, required to set up and maintain a separate and distinct fund for such number of contracts within that series as have matured under the terms thereof, such reserve funds being known as Maturity and Retirement Funds; and that there are, therefore, a total of ten contract reserve funds, required by the terms of the contract to be maintained separate and distinct from each other. Respondent avers that the debtor has not made deposits of securities in the various states in a manner so that the contract liability upon each series of contracts would correspond to the contract fund securities deposited, but on the other hand has deposited any avail- [fol. 131] able securities irrespective of the contract fund

to which they belong against liabilities of contracts of other series; that typical of this practice is the situation prevailing in the State of Virginia where contract fund securities of only one fund are deposited against contract liabilities of eight funds, in the State of Ohio where contract fund securities belonging to two funds are deposited against contract liabilities of nine funds, and in the State of Wisconsin where contract fund securities belonging to four funds are deposited against contract liabilities of nine funds. The respondent says that the following tabulation shows the condition of contract fund deposits as against appropriate contract fund liabilities prevailing in the fifteen states requiring deposits to be made by the debtor. In such tabulation the states are listed vertically, the contract funds horizontally, and in the space at the intersection of the various horizontal and vertical columns the symbol "L" indicates contract liability to contractholders residing in such state, and the symbol "D" indicates that securities belonging to the pertinent contract fund have been deposited in such state. The tabulation does not attempt to show the excess in some states nor the deficiency in other states of the deposits with respect to contract liability:

| [fol. 132] | Spec. Income | Spec. Ann'ty | Spec. Ann. M&R | Series A | Series AM&R | Series B | Series BM&R | Series C | Series D | Series DM&R |
|---|---|---|---|---|---|---|---|---|---|---|
| Alabama | L D | L D | L | L D | | L D | L | | L D | L |
| Delaware | L | L D | L | L D | L | L D | L | | L | |
| Illinois | L | L D | L D | L D | L | L D | L D | | L | |
| Indiana | L | L D | L | L D | L | L D | L | | L | |
| Iowa | L | L D | L | L | | L D | L | | L | |
| Kansas | | L D | L | L | | L D | L | | L | |
| Kentucky | L | L D | L | L | | L | L | | L D | L D |
| Maryland | L | L D | L | L D | | L D | L | | L | |
| Missouri | L D | L D | L D | L D | | L D | L | | L | |
| Ohio | L | L | L | L | L | L | L | | L D | L D |
| Penna | L | L D | L | L | L | L D | L D | | L | |
| Tennessee | L | L D | L D | L | | L D | L D | | L | |
| Virginia | L | L | L | L D | L | L | L | | L | |
| West Va | L D | L D | L D | L D | L D | L D | L D | | L D | L D |
| Wisconsin | L | L D | L | L D | L | L D | L D | L | L | |
| Undeposited Securities | Yes | Yes | Yes | Yes | No | Yes | Yes | No | Yes | Yes |

[fol. 133] This respondent is advised that the several series of contracts constitute separate and distinct classes in each state in which any deposit is required, and that it will be apparent from the foregoing tabulation that there are, therefore, a total of one hundred seventeen classes of creditors of the debtor if classified in accordance with the provisions of the Bankruptcy Act and decisions made with respect thereto. The respondent charges that it is unreasonable to expect that a plan of reorganization could be consummated which would require the consent, or treatment not necessitating the consent, of one hundred seventeen different classes of creditors.

This respondent further charges that the deposited securities in the hands of the various state officials, while subject in a limited way to the jurisdiction of the reorganization court, are not susceptible of being taken into possession and administered by the Trustee inasmuch as in most cases any order interfering with the possession of such state officials would be violative of the Eleventh Amendment of the Constitution of the United States, and that, therefore, the Bankruptcy Court cannot exercise adequate jurisdiction and control over the property and assets of the debtor to effect a plan of reorganization.

Respondent further avers that the debtor is a quasi-public utility, subject to regulation and visitation by various state authorities; that in the proper exercise of the police power, various states have imposed conditions to its doing business and requiring it to obtain licenses therefor, and that before the debtor could resume its business as a going concern and engage in the type of business in which it has heretofore conducted, it would have to obtain the requisite licenses from the proper state authorities, which this respondent avers will not be forthcoming to the debtor if it is reorganized in the face of such opposition by state [fol. 134] authorities as has already developed in this proceeding and in nullification of their respective state laws.

Respondent further avers that it is unreasonable to expect a plan of reorganization to be consummated for the reason that the type of business heretofore conducted by the debtor meets no real need in the economic structure of the country or its citizens; that there is no demand and has been no demand on the part of investors for the type of investment contract which the debtor has in the past sold, but that on the other hand such contracts have been sold through

concentrated sales effort, with the large, unreasonable and uneconomic expense thereof being paid for by the investors to whom such contracts were sold; that in the case of more than half of the contracts sold on the installment plan the purchasers have in the past permitted their contracts to lapse after making a number of payments sufficient in some cases to reimburse the debtor for the cost of selling expense as well as some profit thereon, but insufficient to yield to the holders of said contracts under the terms thereof any cash surrender or loan value. This respondent avers that the debtor has not been able in the past, nor would it be able in the future, under any plan of reorganization such as is proposed in the petition, to realize any profit from the earnings of securities purchased with the proceeds of sale of investment contracts over and above the required improvements thereon for the payment of operating expenses and a reasonable return upon any invested capital, or from any other source except from payments inuring to its benefit on lapsed contracts. This respondent avers that in the proceedings pending in the Circuit Court of Kanawha County, West Virginia, and in a statement made to the contractholders at the time of filing of his bill therein, he was of the opinion that any reorganization or re-
[fol. 135] habilitation of the debtor should provide for a cessation of the type of business in which it had theretofore been engaged and recommended that after such assets of the debtor had been conserved and its affairs reorganized, that it engage in the business of life insurance.

## XIV

The respondent charges that the petition was not filed in good faith within the provisions of Section 146 (4) of the Bankruptcy Act in that prior proceedings are pending in state courts and the interest of creditors would be best subserved in such prior proceedings. Respondent avers that the various states in which the debtor has engaged in business provide complete and adequate means of liquidation of insolvent companies such as the debtor, by courts of competent jurisdiction, and that upon a dismissal of the proceedings herein, if no reorganization could be effected, the state courts could liquidate the assets of the debtor within their respective jurisdictions and distribute the same among those creditors entitled thereto without the

necessity of incurring the unnecessary expense and delay of a multiplicity of plenary suits, which the Trustee or debtor will be forced to bring in order to obtain possession of the assets of the debtor, with no assurance that such suits will be successful.

XV

This respondent is advised that the reorganization court, being a court of equity, should exercise its discretion, upon application of proper state officers, to relinquish its jurisdiction in favor of the officers designated by state statute for the administration of the assets of corporations under their jurisdiction, where the procedure provided by the statute is adequate and complete and accomplishes the [fol. 136] same end in substantially the same manner as would be reached in the reorganization court; and is further advised that the reorganization court as a court of equity should refuse to exercise its jurisdiction where its exercise would be prejudicial to the public interest, and it reasonably appears that the private right will not suffer; and this respondent is further advised that a reorganization court being a court of equity should exercise its discretionary power with proper regard for the rightful independence of state governemnts in carrying out their domestic policy, so as to avoid any unnecessary interference by injunction with the lawful action of state officers.

Respondent charges that the precedure provided by the statute of the State of West Virginia is adequate and complete for the purpose of liquidating the affairs of the debtor in the event reorganization thereof cannot be effected, and that in such event the proceedings herein should be dismissed and the property and assets in the hands of the Trustee returned to the State Court Receivers.

[fol. 137] Wherefore, this respondent prays:

1. That the petition filed herein may be dismissed as not having been filed in the proper Judicial District.

2. That the petition filed herein may be dismissed as not having been filed pursuant to proper corporate action taken by debtor.

3. That the petition herein be dismissed as not having been filed in good faith, either in fact or in law.

4. That the Court will exercise its discretion and relinquish jurisdiction of the debtor in favor of this respond-

ent, and the Receivers therefor appointed by the Circuit Court of Kanawha County, West Virginia, as well as in favor of the various other state officials having jurisdiction of the debtor in other states and the Receivers appointed in such other states.

(S.) Edgar B. Sims, Auditor of the State of West Virginia and ex-officio Insurance Commissioner of the State of West Virginia.

(S.) Clarence W. Meadows, Attorney General of the State of West Virginia. (S.) Ira J. Partlow, Assistant Attorney General.

[fol. 138] *Duly sworn to by Edgar B. Sims. Jurat omitted in printing.*

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[fol. 139] IN THE UNITED DISTRICT COURT

[Title omitted]

ANSWER AND CONTROVERSION OF H. ISAIAH SMITH AND ROSS B. THOMAS, RECEIVERS OF THE DEBTOR, APPOINTED BY THE CIRCUIT COURT OF KANAWHA COUNTY, WEST VIRGINIA—Filed August 4, 1941

To the Honorable Ben Moore, Judge of the District Court of the United States, for the Southern District of West Virginia:

These intervenors, H. Isaiah Smith and Ross B. Thomas, Receivers of Fidelity Assurance Association, appointed by the Circuit Court of Kanawha County, West Virginia, given leave to intervene in this cause and file such answers or other pertinent or necessary pleadings as they might deem appropriate by order entered in this cause on the 12th day of June, 1941, for answer to the petition of the debtor filed herein say:

I

These intervenors have read the answer and controversion of Edgar B. Sims, Auditor of the State of West Virginia and ex-officio Insurance Commissioner of the State of West Virginia, filed or to be filed in this cause, and adopt said answer and controversion as their own with the same force and effect as if the same were set forth in full herein.

II

These intervenors further aver that they have complied with the orders of the Court entered in this cause on the 6th day of June, 1941, and on the 10th day of June, 1941, requiring them to turn over to Central Trust Company, Trustee, all of the assets of the debtor in their possession, but further aver that they obeyed said order for the reason that they did not wish to be compelled to take the risk of being held in contempt of Court for failure to obey the same, and did so after their motion for a stay of said order of June 6, 1941, was denied, said turn-over being made under written protests delivered to the Trustee at the time or times said assets were delivered to the Trustee, said protest in respect of all of the assets of the debtor in their possession except certain segregated funds subject to order entered herein on the 14th day of June, 1941, together with the acceptance thereof, being as follows:

"To Central Trust Company, Trustee for Fidelity Assurance Association, Charleston, West Virginia.

[fol. 140] *Protest and Objection of Receivers*

H. Isaiah Smith and Ross B. Thomas, Receivers of Fidelity Assurance Association, by virtue of an order of the Circuit Court of Kanawha County, West Virginia, entered on the 11th day of April, 1941, and acting as Receivers since said date under the direction of said Court, and by reason of said Receivers having been served with a copy of an order entered by the U. S. District Court for the Southern District of West Virginia on June 6, 1941, requiring them to turn over all property and assets of the Fidelity Assurance Association in their possession or under their control to Central Trust Company, Trustee in Bankruptcy appointed in said Order of June 6, 1941, by said U. S. District Court, and further ordering and requiring them to refrain from any further acts or action with respect to their said appointment as Receivers do hereby, over their objections and protest obey said order, nevertheless stating and believing said Order not to be a valid one, but to be void and of no legal effect, and further stating that they obey said Order only and for no other reason than that they be not compelled to take the risk of being held to be in contempt of said U. S. District Court for failure to obey its order; nevertheless reserving unto themselves as Receivers all of

their legal rights and privileges, including the right to test the legality and validity of said Order of June 6, 1941, the jurisdiction of said U. S. District Court in entering said order and in all other matters arising by virtue of the institution of the proceedings in which said order was entered.

H. Isaiah Smith and Ross B. Thomas, Receivers for Fidelity Assurance Association, by (Signed) H. Isaiah Smith.

Wheeling, West Virginia.
June 10, 1941.

Received original of this paper this 10th day of June, 1941, at 4:03 P. M.

Central Trust Company, by (Signed) R. E. Plott, Treasurer."

and said protest in respect of the turn over of said segregated funds being as follows:

"Charleston, West Virginia,
June 24, 1941.

Central Trust Company,
Charleston, West Virginia.

GENTLEMEN:

I am this day signing and delivering to you drafts covering the transfer to you as Trustee of the segregated funds held by the Receivers of Fidelity Assurance Association, which are the subject of an order of the United States District Court entered in proceedings for reorganization of said corporation on June 14th, 1941.

As stated to your counsel, Mr. Hillis Townsend, these funds are being delivered to you subject to the same protest as that made in connection with the delivery to you of other [fol. 141] assets of Fidelity Assurance Association in our possession.

Very truly yours, H. Isaiah Smith and Ross B. Thomas, Receivers, by (Signed) Ross B. Thomas."

RBT:ML.

III

These intervenors further aver that as alleged in Paragraph VI of the said answer of Edgar B. Sims, Auditor, etc., the said Edgar B. Sims, Auditor, etc., filed a bill in the

Circuit Court of Kanawha County for the administration of the assets of the debtor as an insolvent, and that under the laws of the State of West Virginia in such cases made and provided the Insurance Commissioner of the State of West Virginia, whenever any company under his supervision and regulation shall become insolvent or be in such financial condition as not to be able to pay its creditors in this state, may file a bill in the Circuit Court of Kanawha County for the administering of the assets of such company as an insolvent and for the purpose of taking possession of its property in this state and the distribution of its assets among those entitled thereto according to their respective right. These intervenors aver that under the laws of the State of West Virginia the Insurance Commissioner in such suit was himself entitled to possession of all of the property of the debtor in the State of West Virginia but for the purpose of facilitating the marshaling of all of the assets of the debtor not deposited with the State of West Virginia pursuant to its statutes, and the administration thereof, he requested and caused these Receivers therefor to be appointed by the Circuit Court; and these intervening Receivers allege and aver that under the circumstances of their appointment and under the laws of the State of West Virginia applicable thereto they are in fact the agents of the Insurance Commissioner of the State of West Virginia, appointed for the purpose of taking possession of certain of the property of the debtor and administering it in conjunction with and under the supervision of the Insurance Commissioner of the State of West Virginia, subject to the proper orders of the Circuit Court of Kanawha County, West Virginia, and further allege that under the provisions of Chapter 33, Article 2, Section 36, it is provided that all [fol. 142] accounts rendered to any court by the Receiver of any insolvent insurance company of the State of West Virginia shall be presented by such receiver to the Insurance Commissioner for his examination, and the Commissioner shall report thereon to the Court to which said accounts are rendered before the same shall be accepted by said Court, and that receivers of insurance companies shall report to the Insurance Commissioner annually, or oftener in case he shall so direct, in such forms as he shall prescribe. These intervenors aver that by the provisions of Chapter 33, Article 9, Section 10, the Insurance Commissioner is given the same authority over the debtor as

he has over insurance companies. These intervenors are advised that under the circumstances of their appointment and under the laws of the State of West Virginia, that in their capacity as Receivers of the debtor they are agents of the Insurance Commissioner and are entitled to and clothed with the same immunities as are given the Auditor of the State of West Virginia, ex-officio Insurance Commissioner of the State of West Virginia, as an officer of the State of West Virginia.

Wherefore, these intervenors pray:

1. That the petition filed herein may be dismissed as not having been filed in the proper Judicial District.

2. That the petition filed herein may be dismissed as not having been filed pursuant to proper corporate action taken by debtor.

3. That the petition herein be dismissed as not having been filed in good faith, either in fact or in law.

4. That the Court will exercise its discretion and relinquish jurisdiction of the debtor in favor of the Insurance Commissioner of the State of West Virginia and the undersigned Receivers therefor appointed by the Circuit Court of Kanawha County, West Virginia.

5. That the orders entered in this cause on the 6th day of June, 1941, and on the 10th day of June, 1941, requiring said Receivers to turn over to the Trustee for the debtor all of the assets and property of the debtor in their possession be vacated, and that the Trustee be ordered to relinquish possession of and turn over to these intervening Receivers the property and assets of the debtor taken from them pursuant to the aforesaid orders, and that the Court will enter such other and further orders as may be neces- [fols. 143-154] sary to restore such possession to said Receivers.

H. Isaiah Smith and Ross B. Thomas, Receivers of Fidelity Assurance Association, appointed by the Circuit Court of Kanawha County, West Virginia.

Koontz & Koontz, Counsel for Receivers.

Ross B. Thomas and J. Campbell Palmer III, 501 Union Bldg., Charleston, W. Va.

H. I. Smith and Ross B. Thomas. Jurat omitted in printing.

[fol. 155] IN UNITED STATES DISTRICT COURT

[Title omitted]

ORDER FILING TRUSTEE'S REPORT, ETC.

This day came the Central Trust Company, Trustee herein, and presented and asked leave to file its Trustee's Report No. 2, together with its exhibits, marked for identification Exhibits A, B, C, D, E, F, G, H, J, K, L, and M; and the Court having examined the said report and exhibits, and the same appearing in all respects proper, the said report is hereby ordered filed.

And it appearing to the Court that numerous ones of the exhibits filed with said report are of a voluminous nature, and it further appearing that two copies of each of said exhibits could not conveniently be made and filed as required by the order entered herein on June 13, 1941, it is hereby ordered that copies of the said exhibits need not be filed.

Ben Moore, U. S. D. J.

August 5, 1941.

(The Trustee's Report, referred to in the foregoing order, is in the words and figures as follows:)

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[fol. 156] IN UNITED STATES DISTRICT COURT

[Title omitted]

TRUSTEE'S REPORT No. 2—Filed August 5, 1941

To the Honorable Ben Moore, Judge of Said Court:

The Central Trust Company, heretofore appointed Trustee in the above cause, respectfully reports unto Your Honor as follows:

1. That in the operation of the debtor's business said Trustee has received cash and disbursed cash as shown by an itemized statement thereof filed as a part of this report and marked for identification "Trustee's Cash Receipts and Disbursements", "Exhibit A".

2. That in compliance with orders of Your Honor heretofore made and entered herein, the Trustee has notified the

custodians of the assets of the debtor of its appointment as Trustee and has demanded delivery of the same to your Trustee, all as more particularly shown by form copies of letters addressed to the various custodians, as set out in a list of the same filed with and made a part of this report and marked for identification "Trustee's Notice to Custodians of Debtor's Assets", "Exhibit B".

3. Your Trustee further respectfully reports that the assets of the debtor held by the various custodians as shown by the books and records of said debtor, but not verfied by your Trustee with said custodians, are particularly described in a detailed list thereof filed with and made a part of this report, entitled "Fidelity Assurance Association Schedule of Security Deposits by States, April 10, 1941, Adjusted to June 6, 1941", and marked for identification "Exhibit C".

4. Your Trustee further reports unto Your Honor that although demand has been made on each of said custodians or security holder of the debtor's assets, as particularly set out in "Exhibit B" aforesaid, it has not received any of the said securities except those described in the list filed herewith and made a part of this report, which said list is entitled "Securities Delivered to Trustee" and marked for identification "Exhibit D."

5. Your Trustee further reports that there are now outstanding certain unpaid bills which were incurred prior to [fol. 157] the State Court receivership and during the administration of the State Court Receivers from April 11 to June 6, 1941, which bills were incurred principally in the operation of the home office and branch offices of the debtor. Your Trustee makes no report as to the validity of the claims which might be presented by the creditors indicated by this list. Your Trustee submits said list with and as a part of this report, said list being marked for identification as "Exhibit E."

6. Your Trustee further reports that immediately prior to the appointment of the State Court Receivers on April 11, 1941, there had been issued by the debtor numerous checks payable from the various funds of the debtor, which checks had not been paid by the respective banks upon which they were drawn at the time of the appointment of the State Court Receivers. Your Trustee reports that these

checks are still outstanding and unpaid and that a list thereof is filed herewith as a part of this report entitled "Outstanding Checks" and marked for identification "Exhibit F".

7. Your Trustee further reports that there are outstanding as of June 6, 1941, 8123 shares of common stock of the debtor; that said common stock is owned by approximately 400 stockholders; and that there is filed herewith and made a part of this report a list showing the name of each stockholder and his or her post office address or place of business, marked for identification "Exhibit G".

8. Your Trustee further reports that there are outstanding as of June 6, 1941, 9110 shares of the preferred stock of the debtor, which said preferred stock is owned by approximately 1000 different preferred stockholders, and that a list is filed herewith and made a part of this report showing the names and post office address or the address of the place of business of each of said stockholders, and marked for identification "Exhibit H".

9. Your Trustee reports that the principal creditors of the debtor consists of the owners of its various types of investment contracts, of which approximately 80,000 are now in force, and for which a reserve liability is carried on the books of the debtor; that there is filed herewith as a part of this report a list showing the name and post office address or place of business of the owner of each of such contracts. The said list contains in addition to the foregoing the following information concerning each contract:

[fol. 158] (a) Contract number.

(b) Number of payments made on contract.

(c) Actuarial reserve (this figure supports the reserve as shown on the Balance Sheets).

(d) Cash liability.

(e) Loans to contract owners.

(f) Additional credits (this applies only to series "B" contract owners).

There is also included as a part of the aforesaid list of contract holders a summary of each class of contract, showing the number of contracts thereof, the face amount, reserve

liability and cash surrender liability and contract loans and accrued interest thereon. In addition thereto there is shown as a part of said list of contract holders a list of the owners who have made payments on their contracts between April 4 and June 6, 1941. The aforesaid list is submitted to the Court in a sealed container and marked for identification "Exhibit J".

10. Your Trustee further reports that between April 10 and June 6, 1941, a number of the contract holders of the debtor made payments of interest and/or principal upon loans which they had theretofore obtained upon their contracts; that there is submitted herewith as a part of this report a list showing the names of such persons, the serial number of their respective contracts, the amounts of the payments made by such contract holders on their loans, and the amounts of payments made by such contract holders as interest on their loans, which said list is filed herewith as a part of this report marked for identification "Exhibit K".

11. Your Trustee reports that it has caused to be prepared as of June 6, 1941, a balance sheet of the assets and liabilities of the debtor, which balance sheet discloses the condition of the various funds as shown by the records of the debtor. A copy of said balance sheet is filed herewith as a part of this report and is marked for identification "Exhibit L".

12. Your Trustee further reports that it has caused to be prepared from the books and records of the debtor, but not verified by your Trustee by actual check of securities not in your Trustee's possession, as of June 6, 1941, a schedule showing the par value, book value and market value by funds of all securities owned by the debtor and the location [fols. 159-160] thereof, a copy of said schedule being filed herewith as a part of this report and marked for identification "Exhibit M".

Respectfully submitted, Central Trust Company, Trustee, by /s/ A. A. Payne, Vice President & Trust Officer.

August 5, 1941.

(Exhibits B, C, D, L & M, referred to in the foregoing order, are being transmitted in original form in accordance with instructions of Court Order entered March 7, 1942.)

[fol. 161] IN UNITED STATES DISTRICT COURT

[Title omitted]

MOTION TO INTERVENE—Filed August 5, 1941

Dewey S. Godfrey, Receiver, moves for leave to intervene as defendant in this action, in order to assert the defenses set forth in his proposed petition to vacate and his proposed answer, of which copies are attached hereto, on the ground that under the order appointing him Receiver, a copy of which is attached hereto, his interest, as Receiver in protecting the Missouri contract holders and their liens on the securities deposited by the Debtor for Missouri contract holders under orders of the Securities Commissioner of the State of Missouri, will not be adequately represented in the above reorganization proceedings and movant will be bound by any judgment entered therein regarding your movant's duties as Receiver in Missouri and as guardian and protector of the liens and interests of the Missouri contract holders by reason of the securities deposited by the said Debtor to secure the payment of said contracts and in accordance with the rules, regulations, and public policy of the State of Missouri and its officials; also this movant, as Receiver of the assets and affairs of the Debtor company in the State of Missouri, is so situated with reference to certain securities deposited by the Debtor for the State of Missouri as to make him adversely affected by distribution or other disposition of property in the custody of or under the direction of this Court or the said Trustee appointed by this Court for the above named Debtor.

(Signed) Dewey S. Godfrey, Receiver of the Fidelity Assurance Association in the State of Missouri.

[fols. 162-166] *Duly sworn to by Dewey S. Godfrey. Jurat omitted in printing.*

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[fol. 167] IN UNITED STATES DISTRICT COURT

[Title omitted]

PETITION TO VACATE—Filed August 5, 1941

Comes now Dewey S. Godfrey, Receiver, and respectfully represents:

1. That on June 6th, 1941 a petition was filed herein by the Fidelity Assurance Association, the above named debtor,

praying that proceedings he had under Chapter 10 of the Act of Congress relating to Bankruptcy, and on said June 6th, 1941 an order was entered by this Court approving said petition and appointing the Central Trust Company of Charleston, West Virginia, as Trustee, said order of June 6th, 1941 being amended by this Court on June 10th, 1941.

2. That this Court is without jurisdiction over the subject matter because the debtor is an insurance company and as such is precluded from becoming a bankrupt or becoming reorganized in bankruptcy.

3. That the Court is without jurisdiction over the subject matter because debtor's petition filed herein shows on its face that the debtor is an insurance company and precluded from becoming a bankrupt or being reorganized in bankruptcy.

4. That the petition does not show that it was filed in good faith and that a feasible plan for reorganization could be arrived at and determined upon.

5. That the petition filed by debtor herein was not filed in good faith because in order to effect reorganization each and every one of all of the contracts sold by debtor and mentioned in debtor's petition would have to be rewritten and readjusted. the provisions therein changed, readjustments made with reference to options mentioned therein, readjustments made in cash value and paid-up contract value, a rewriting and readjustment of the reserve fund, the maturity and retirement reserve fund, the surplus participations, the cash commuted value, the optional settlements, the options settlements schedule, the insurance protection features and the provisions relating thereto with [fol. 168] reference to, protection for contract, fully paid contract, no further payments, increased cash availability, conditions of protection, termination of protection, reinstatement of protection, reserve requirements, and general terms; a rewriting and readjustment of the provisions relating to additional credits and contracts without insurance relating to annual credits, compound accumulated interest, payment of accumulated credits, increased value, and, reserve provisions; a rewriting and readjustment of the provisions of said contracts with reference to, discount for advance payments, paid-up contract and automatic conversion, grace and new contract, cash availability, advance

loan for payments, and, cash loan; that on numerous contracts issued by the debtor there is attached thereto a life insurance policy issued by the Lincoln National Life Insurance Company of Fort Wayne, Indiana, written and issued in accordance with and based upon the provisions in said annuity contracts issued; that a rewriting and readjustment of the provisions of the annuity contract would also require a rewriting and readjustment of the said life insurance policy; that various series of contracts have been issued and outstanding in the State of West Virginia and various other nineteen states of the United States, and varying amount of securities deposited with the said other states or their officials to insure the payment of said contracts; that the said deposit of securities with said other states and their officials as just stated is in accordance with the laws, regulations and public policy of said states for the security and protection of its citizens; that reorganization is not feasible in that said debtor cannot and will not be able to comply with the provisions of the Investment Company Act of 1940 as enacted by the Congress of the United States and approved by the President; that the said debtor well knew of all of the above at the time the petition for reorganization was filed herein and well knew that reorganization was impossible.

6. That there are prior proceedings pending in the State of Missouri and other of the nineteen states of the United States regarding annuity contract holders of debtor in said states which would best serve the interests of the creditors [fol. 169] of said debtor which creditors are composed of the said contract holders.

Wherefore, your Intervenor prays: (1) That the order entered herein on the 6th day of June, 1941 and as amended June 10th, 1941 approving the petition of said debtor praying that proceedings be had under Chapter X of the Act of Congress relating to Bankruptcy and enjoining and staying the proceedings theretofore commenced in the State of Missouri be vacated; (2) That debtor's petition for reorganization filed herein be dismissed; (3) That your petitioner have such other and further releases as is just.

(Signed) Dewey S. Godfrey, Receiver of the Fidelity Assurance Association in the State of Missouri.

(Signed) Rudolph K. Schurr, Attorney for Receiver, 705 Olive Street, St. Louis, Missouri.

[fol. 170] IN UNITED STATES DISTRICT COURT

[Title omitted]

ANSWER—Filed August 5, 1941

Comes now intervenor, Dewey S. Godfrey, Receiver, and for his answer to debtor's petition, admits as to paragraph numbered I of debtor's petition that debtor is a corporation, duly organized and existing under the laws of the State of West Virginia and that said debtor was so incorporated on the 26th day of April, 1911 as the Fidelity Investment Loan Association and that its name was thereafter changed to Fidelity Investment Association and on or about December 31st, 1940 its name was again changed to Fidelity Assurance Association. For answer to the rest of the allegations in said paragraph I intervenor states that he is without knowledge or information sufficient to form a belief as to the truth of the averments contained therein.

For answer to paragraphs numbered II and III intervenor states that he is without knowledge or information sufficient to form a belief as to the truth of the averments contained therein.

Intervenor admits the allegations contained in paragraph numbered IV of debtor's petition.

For answer to paragraphs numbered V, VI, VII and VIII of debtor's petition intervenor states that he is without knowledge or information sufficient to form a belief as to the truth of the averments contained therein.

For answer to paragraph numbered IX of debtor's petition, intervenor denies each and every allegation of fact therein contained.

For answer to paragraph numbered X of debtor's petition, intervenor states that he is without knowledge or information sufficient to form a belief as to the truth of the averments contained therein.

For further answer to petition filed by debtors herein, intervenor respectfully represents:

1.) That this Court is without jurisdiction over the sub-
[fol. 171] ject matter because the debtor is an insurance company and as such is precluded from becoming a bankrupt or becoming reorganized in bankruptcy.

2.) That the petition filed by debtor herein was not filed in good faith because in order to effect reorganization each

and every one of all of the contracts sold by debtor and mentioned in debtor's petition would have to be rewritten and readjusted, the provisions therein changed, readjustments made with reference to options mentioned therein, readjustments made in cash value and paid-up contract value, a rewriting and readjustment of the reserve fund, the maturity and retirement reserve fund, the surplus participation, the cash commuted value, the optional settlements, the optional settlements schedule, the insurance protection features and the provisions relating thereto with reference to, protection for contract, fully paid contract, no further payments, increased cash availability, conditions of protection, termination of protection, reinstatement of protection, reserve requirements, and general terms; a rewriting and readjustment of the provisions relating to additional credits and contracts without insurance relating to annual credits, compound accumulated interest, payment of accumulated credits, increased value, and, reserve provisions; a rewriting and readjustment of the provisions of said contracts with reference to, discount for advance payments, paid-up contract and automatic conversion, grace and new contract, cash availability, advance loan for payments, cash loan, warrant and cash surrender and the schedules with reference to, paid-up contract and automatic conversion, cash availability, advance loan for payments, and, cash loan; that on numerous contracts issued by the debtor there is attached thereto a life insurance policy issued by the Lincoln National Life Insurance Company of Fort Wayne, Indiana, written and issued in accordance with and based upon the provisions in said annuity contracts issued; that a rewriting and readjustment of the provisions of the annuity contract would also require a rewriting and readjustment of the said life insurance policy; that various series of contracts have been issued and outstanding in the State of West Virginia and various other nineteen states of the United States, and varying amount of securities deposited with the said other states or their officials to insure the payment of said contracts; that the said deposit of [fol. 172-173] securities with said other states and their officials as just stated is in accordance with the laws, regulations and public policy of said states for the security and protection of its citizens; that reorganization is not feasible in that said debtor cannot and will not be able to comply with the provisions of the Investment Company Act of

1940 as enacted by the Congress of the United States and approved by the President; that the said debtor well knew of all of the above at the time the petition for reorganization was filed herein and well knew that reorganization was impossible.

3.) That there are prior proceedings pending in the State of Missouri and other of the nineteen states of the United States regarding annuity contract holders of debtor in said states which would best serve the interests of the creditors of said debtor which creditors are composed of the said contract holders.

(Signed) Dewey S. Godfrey, Receiver of the Fidelity Assurance Association in the State of Missouri.

(Signed) Rudolph K. Schurr, Attorney for Receiver, 705 Olive Street, St. Louis, Missouri.

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[fol. 174] IN UNITED STATES DISTRICT COURT

[Title omitted]

MOTION TO VACATE OR MODIFY ORDER OF JUNE 10, 1941— Filed August 5, 1941

Now comes John B. Gontrum, Insurance Commissioner of the State of Maryland, appearing specially and for the sole purpose of prosecuting this motion, and moves this Honorable Court to vacate its order passed herein on June 10, 1941, modifying the order passed herein on June 6, 1941, or, in the alternative, to modify said order by striking therefrom the last paragraph thereof, and by providing that said order shall not be applicable to the securities heretofore assigned to and deposited with the Insurance Commissioner of Maryland by the Debtor. And for cause of his said motion, this Movant says that this Honorable Court was without jurisdiction to pass its said order of June 10, 1941, modifying its said order of June 6, 1941, because:

1. The securities heretofore assigned to and deposited with the Insurance Commissioner of the State of Maryland by the Debtor were so assigned and deposited in accordance with the laws of the State of Maryland, Sections 218

to 234, inclusive, of Article 48A of the Code of Public General Laws of Maryland as enacted by Chapter 530 of the Acts of 1931, and the said securities are now, under the said laws of the State of Maryland, in the custody and pos- [fol. 175] session of this Movant as Insurance Commissioner of the State of Maryland. As Insurance Commissioner of the State of Maryland, this Movant is the mere agent of the State of Maryland and in his capacity as such, is beyond the reach of the judicial power of this Honorable Court, and the order of this Honorable Court of June 10, 1941, modifying the previous order of June 6, 1941, in so far as it is directed against this Movant as Insurance Commissioner of the State of Maryland, is void under the Eleventh Amendment to the Constitution of the United States.

2. This Court has no jurisdiction *in personam* over this Movant as Insurance Commissioner of the State of Maryland because he does not reside in the Southern District of West Virginia and is not subject to the service of process therein and has not been served with process therein.

3. The securities assigned to and deposited with the Insurance Commissioner of the State of Maryland by the Debtor were, in accordance with the laws of the State of Maryland, so deposited and assigned, and are now held by this Movant, in trust, as security for all the holders of contracts or other obligations of the Debtor sold, negotiated, issued or accrued in the State of Maryland, and said securities therefore do not constitute property of the Debtor within the meaning of Chapter 10 of the Bankruptcy Act so as to give this Honorable Court jurisdiction thereover.

4. The securities heretofore assigned to and deposited with the Insurance Commissioner of the State of Maryland by the Debtor were, in accordance with the laws of the State of Maryland, so assigned and deposited, and are now held by this Movant, in trust as security for all the holders of contracts or other obligations of the Debtor sold, negotiated, issued or accrued in the State of Maryland, and title thereto is now in this Movant and not in the Debtor. This Movant, [fol. 176] therefore, has a substantial adverse claim to and title in said securities, and this Honorable Court therefore has no jurisdiction to require this Movant, by summary order, to surrender the said securities to the Trustee appointed herein by this Honorable Court, and a plenary

action against this Movant in a proper forum would be necessary to enable the Trustee designated herein to recover possession of said securities from this Movant.

5. This Honorable Court has no jurisdiction under Chapter 10 of the Bankruptcy Act to declare, in a summary order passed herein without notice to this Movant, that the securities heretofore assigned to and deposited with the Insurance Commissioner of the State of Maryland by the Debtor, in accordance with the laws of said State, are property of the Debtor within the meaning of Chapter 10 of the Bankruptcy Act.

6. The securities heretofore assigned to and deposited with the Insurance Commissioner of the State of Maryland by the Debtor, and now held by this Movant as such Insurance Commissioner, were assigned and deposited in accordance with the laws of the State of Maryland, Sections 218 to 234 of Article 48A of the Code of Public General Laws of Maryland, and under an agreement made with the Insurance Commissioner of Maryland, pursuant to said laws, that said securities should be held by said Insurance Commissioner of the State of Maryland in trust as security for all the holders of contracts of the Debtor sold, negotiated, issued or accrued in the State of Maryland. The assignment and deposit of said securities in accordance with the said laws of the State of Maryland, and the agreement with the Insurance Commissioner of the State of Maryland made pursuant thereto, constitute a contract in the public authority within the meaning of Chapter 10 of the Bankruptcy Act, and this Honorable Court is without jurisdiction to reject, alter, modify or abrogate said contract.

[fols. 177-180] 7. The laws of the State of Maryland, Sections 218 to 234, inclusive, of Article 48A of the Code of Public General Laws of Maryland, under which the Debtor was required to assign to and deposit with the Insurance Commissioner of the State of Maryland the securities now held by this Movant, were enacted by the State of Maryland for the better protection of its citizens in the exercise of the powers reserved to it as a sovereign State by the Tenth Amendment to the Constitution of the United States, and the bankruptcy laws of the United States cannot and do not infringe upon such laws of the State of Maryland. Therefore, this Honorable Court has no jurisdiction under

any supposed authority conferred by the Bankruptcy Act, to require this Movant as Insurance Commissioner of the State of Maryland to surrender such securities to the Trustee herein in disregard of the laws of the State of Maryland.

(S.) John B. Gontrum, Insurance Commissioner of the State of Maryland. (S.) H. Vernon Eney and Guy B. Brown, Attorneys for John B. Gontrum, Insurance Commissioner of the State of Maryland, appearing specially and for the sole purpose of prosecuting this motion.

*Duly sworn to by John B. Gontrum. Jurat omitted in printing.*

[fol. 181] IN UNITED STATES DISTRICT COURT

[Title omitted]

ANSWER—Filed nunc pro tunc as of August 4, 1941

To the Honorable Ben Moore, Judge of the District Court of the United States, for the Southern District of West Virginia:

L. H. Brooks, Frederic Leake, and A. L. Goldberg, Jr., allege that they are creditors of Fidelity Assurance Association, the above named debtor. L. H. Brooks, as Trustee for his son, —— Brooks, is the holder and owner of a certificate issued by the debtor corporation on which he has paid $1650.00 and which has fully matured in the amount of $2500.00. A. L. Goldberg, Jr., is Trustee for Richard Goldberg, and is the holder and owner of a certificate for $2500.00, on which he has paid the debtor the sum of approximately $390.00. Frederic Leake is the holder and owner of a certificate for $1250.00 on which he has paid the sum of $15.00 monthly from June 25, 1940, through March, 1941. For answer to the petition of the debtor verified [fol. 182] June 5th, 1941, and filed June 6th, 1941, praying that proceedings be had under Chapter X of the Act of Congress relating to bankruptcy, they answer as follows:

*First Defense*

(1) The allegations contained in Section I of the petition are admitted.

(2) It is denied that the debtor is a corporation as defined by the Federal Bankruptcy Act which could be adjudged a bankrupt under said Act.

(3) The allegations contained in Section III of the petition are admitted.

(4) They are without knowledge or information sufficient to form a belief as to the truth of the allegations contained in Section IV of the petition.

(5) They are without knowledge or information sufficient to form belief as to the truth of the allegations contained in Section V of the petition.

(6) They admit the allegations contained in Section VI of the petition.

(7) They admit the allegations contained in the first paragraph of Section VII of the petition. They admit the allegation in the second paragraph of Section VII of the petition that the debtor has been unable to meet its obligations [fol. 183] as they mature. Respondent L. H. Brooks would show that prior to the filing of the receivership proceedings in the State Court in West Virginia, he made demand upon the debtor corporation for payment of the amount due him under his secured contract and payment has not been made to this date. They deny that if the rights of the outstanding contract holders are modified as suggested in the second paragraph of Section VII of the petition, debtor will be able to meet its reserve requirements and will be able to comply with the Investment Company Act of 1940 and will be enabled to resume the operation of its business. They admit that the existing and outstanding contracts of the debtor sold in the State of Tennessee are secured by a deposit of securities made in the State of Tennessee and that some of the deposits were made in other states but the exact amount of those deposits and the various States in which the deposits were made are unknown to respondents. They construe the allegation in the second paragraph of Section VII of the petition "that the rights of all contract holders must be modified as above set forth in order that debtor may be permitted to obtain adequate relief" to mean that the holders of existing and outstanding contracts of the debtor will have to give up some of their rights

and interests in the deposits made with the different States in which the Company is doing business for the protection of such contract holders and deny that this can lawfully be required of them.

Respondents further say that this debtor was not entitled to file this petition under Chapter X of the Bank[fol. 184] ruptcy Act because the rights of the secured contract holders in the securities deposited with the several States in which the Company was doing business for the protection of contract holders in those States cannot be affected or impaired in any way by the reorganization proceedings.

(8) The allegations contained in Section VIII of the petition are admitted.

(9) The allegation that it was the desire of debtor that a plan of reorganization be effected under the provisions of Chapter X of the Bankruptcy Act is denied.

(10) The allegations contained in Section X of the petition are denied.

(11) All allegations contained in the petition, not heretofore expressly admitted or denied are here and now generally denied as fully as if separately and specifically denied.

*Second Defense*

(12) The statutes of the State of Tennessee require investment companies, such as the debtor, engaging in business in that State, to deposit and maintain securities at no time less than 100% of the issuing company's cash or current contract liability on all outstanding investment contracts sold in the State of Tennessee. By Chapter 209 of [fol. 185] the Public Acts of 1939, it was provided that the Commissioner of Insurance and Banking of the State of Tennessee should hold as Custodian the securities deposited for the benefit of the holders of the investment contracts coming within the provisions of said Act. By Chapter No. 157 of the Public Acts of 1941, the State Treasurer of Tennessee was made the Custodian of all securities deposited with the State or any Department thereof. The laws of Tennessee further provide that only upon discharge in full of all liabilities on all investment contracts sold in the State of Tennessee, and for which trust deposit

is maintained, shall the issuing company be entitled to a release and return of the securities so deposited.

In compliance with the laws of the State of Tennessee, and in order to obtain a permit to do business and issue its investment contracts in the State of Tennessee, the debtor company made a deposit of securities with the Commissioner of Insurance and Banking of the State of Tennessee. After receivers had been appointed for the debtor company in the State Court of West Virginia, respondents, on April 21st, 1941, filed a bill in the Chancery Court of Davidson County, Tennessee, for the benefit of themselves and all other holders of investment contracts sold in the State of Tennessee to enforce the lien of said securities and to obtain distribution among the contract holders for whose benefit the deposit was made. Such proceedings in said suit were had as resulted in the entry of a decree of the Chancery Court of Davidson County in said cause styled L. H. Brooks, et al. v. Fidelity Assurance Association, et al., [fol. 186] Rule No. 57686, on April 24th, 1941, sustaining said bill as a General Creditor's bill for the benefit of all the holders of investment contracts of the debtor company sold in the State of Tennessee and impounding said securities by directing the Commissioner of Insurance and Banking of the State of Tennessee to deliver the securities to the State Treasurer in accordance with the provisions of Chapter 157 of the Public Acts of 1941, and enjoining the State Treasurer from making any disposition of said securities except under orders or decrees of the Court in said cause. Said decree directed that publication be made notifying all the holders of investment contracts sold in the State of Tennessee to file and prove their claims against the investment company on or before the first day of November, 1941. By a decree entered in said cause, it was further ordered that publication be made for the Receivers of Fidelity Assurance Association appointed by the Circuit Court of Kanawha County, notifying them of the filing of the bill requiring them to appear and answer at an early rule day of Court and to show cause, if any they might have, why the securities impounded should not be sold and distributed for the benefit of the holders of investment contracts of the defendant corporation sold in the State of Tennessee. Publication was made in accordance with the directions contained in said decrees and an order pro con-

fesso was duly entered against the defendant, Fidelity Assurance Association, and the Receivers appointed in the State Court of West Virginia. Since that time various contract holders have filed claims aggregating approximately $—.

[fol. 187] A duly certified transcript of the proceedings in said suit in the Chancery Court of Davidson County, Tennessee, is annexed hereto as Exhibit "A" and made a part of this answer.

(13) Respondents aver that the securities deposited in the State of Tennessee are impressed with a lien in favor of the holders of investment contracts of the debtor company sold in the State of Tennessee which may not be avoided under any of the provisions of the Bankruptcy Act, and the Chancery Court of Davidson County, Tennessee, has exclusive jurisdiction to make the distribution among the contract holders entitled to the benefit of the deposit.

Respondents deny that there can be any plan of reorganization of the debtor which will be fair and equitable and feasible unless said plan gives full recognition to the statutes of the State of Tennessee above referred to providing that only upon discharge in full of all liabilities on investment contracts sold in the State of Tennessee and for which the deposit in that State is maintained, shall the issuing company be entitled to a release and return of the securities so deposited. They say that a trustee appointed to effect a plan of reorganization stands in the shoes of the debtor corporation.

Respondents would show to the Court that they will not consent to any plan of reorganization which deprives them [fol. 188] of any of their right, title or interest in the deposited securities in the State of Tennessee and they believe that all of the other contract holders for whose benefit said deposit of securities in the State of Tennessee is maintained will feel the same way when they are informed of the situation. They are advised and aver that this Court cannot, against the consent of any contract holder for whose benefit the deposit of securities was maintained in the State of Tennessee, take away the right of that contract holder to have his money that he is entitled to paid back to him out of deposited securities.

*Third Defense*

(14) They allege that it is unreasonable to expect that a plan of reorganization of debtor corporation can be effected herein.

(15) They aver that at the time of the filing of the petition herein prior proceedings were pending in the Courts in various States in which the debtor company was doing business (as disclosed by pleadings herein), and it appears that the interests of creditors would be best subserved in such prior proceedings.

(16) They aver that on December 14th, 1938, the Securities & Exchange Commission filed an action for an injunction in the United States District Court for the Eastern District of Michigan, Southern Division, against the debtor [fol. 189] company, then known as Fidelity Investment Association, alleging that the company was engaged in acts and practices in the sale of its securities which constituted violations of the fraud provisions of the Securities Act of 1933. On the same day an order for the defendant to show cause was issued and on December 22nd, 1938 the company filed an answer to the bill generally denying all allegations of impropriety. On the same day defendant association gave its consent to a final judgment enjoining it from engaging in the acts alleged in the complaint. This proceeding seriously impaired the public confidence in the defendant company. The petition shows that for five months prior to the filing of the petition it had not engaged in business of issuing investment contracts because it could not comply with the Investment Act of 1940. Then followed the receivership in the State Court of West Virginia. And finally this bankruptcy proceeding. The petition shows that the company is not now licensed to do either an insurance business or a business as investment company anywhere. Most of the investors who have bought the defendant's investment contracts are people of moderate means who have put their savings in this company. They are tired of the changing of names and receivership and bankruptcy proceedings and want to get their money out of the deposits protecting their contracts. If there are any contract holders who would give their consent to a reorganization, it is those who have no protection by way of deposited securities.

Those who have an interest in the securities cannot be expected to consent to give up their interest. Yet the petition shows that the rights of *all* contract holders must be modi- [fol. 190] fied in order that the debtor may be permitted to obtain adequate relief.

*Fourth Defense*

(17) Respondents allege that the petition was not filed in good faith.

(18) Respondents aver that the petition was filed with liquidation in mind. The end sought to be gained by the petition was to get a final order approving the petition under Chapter X which would be followed by an order adjudging the debtor a bankrupt and directing that bankruptcy be proceeded with.

Wherefore, respondents pray that the petition be dismissed with costs.

L. H. Brooks, Trustee; Frederic Leake, A. L. Goldberg, Jr., Trustee; Answering Creditors.

(S.) Fyke Farmer, Attorney for Answering Creditors. Address: American National Bank Bldg., Nashville, Tennessee.

[fol. 191] *Duly sworn to by Fyke Farmer. Jurat omitted in printing.*

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[fol. 192] (At a District Court of the United States for the Southern District of West Virginia, at Charleston, in said District, on August 9, 1941.)

In the Matter of FIDELITY ASSURANCE ASSOCIATION, Debtor

Proceedings for Corporate Reorganization

No. 4514

ORDER MODIFYING ORDERS OF JUNE 6 AND JUNE 10, 1941

This day came the Central Trust Company, Trustee for the debtor herein and presented to the court its motion in writing, which is hereby ordered filed, moving the court that an order entered herein on June 6, 1941 and an order entered herein on June 10, 1941 be modified in the respects specified in said petition.

And it appearing to this court from said petition and from the proceedings heretofore had herein that said petition is presented herein pursuant to an informal conference called at the instance of this court on July 9, 1941 and held

in the court room of this court at two o'clock in the afternoon of said day; that said conference was attended by the representatives of official depositaries of various of the states in which contracts of the debtor herein were sold prior to the filing of the petition herein, and was also attended by representatives of receivers appointed in certain of such states by the Trustee herein and its counsel and by an attorney for the Securities and Exchange Commission; and

It further appearing that said conference of July 9, 1941 was called by this court for the purpose of working out by agreement a feasible and equitable method to secure the co-operation of said state depositaries, receivers and others to facilitate the administration of debtor herein; and

It further appearing that portions of said orders of June 6 and June 10, 1941, would impede or prevent such co-operation, with resultant expense which can be avoided by modifying such portions of said order; and

It further appearing to this court that modification of said orders in the respects hereinafter indicated, will promote co-operation among the parties without adversely affecting the estate of the debtor herein or the rights of any of the persons interested in said estate.

And it further appearing to the court that certain of the receivers appointed by the respective state courts including the receivers appointed in Ohio and West Virginia have turned over, the latter under protest, to the Trustees herein the property in the custody, possession or control of each of them as such receiver, now therefore upon the petition of the Central Trust Company, Trustee for the debtor herein, duly verified the 9th day of August, 1941, which petition was joined in at the hearing thereon by counsel for the Treasurer of the State of Ohio and for the official depository of the State of Illinois, upon petitions for relief of a similar nature filed herein by other persons in interest and upon all the proceedings heretofore had herein, including the informal conference hereinbefore referred to, held in this court on July 9, 1941;

It is ordered that the order of this court dated June 6, 1941, be amended by striking therefrom the following language:

"It is further ordered that the receivers, H. Isaiah Smith and Ross B. Thomas, heretofore appointed by the Circuit

Court of Kanawha County, West Virginia, of the property and assets of said debtor situate in the States of West Virginia, be and hereby are directed and ordered to surrender and deliver to said trustee all of the property, assets and business of the debtor, of whatsoever nature and wheresoever situated, now in their possession and control; and said receivers and their agents and employees are hereby expressly enjoined and restrained from in anywise interfering with the exclusive possession and control of said trustee of said property and assets of said debtor and from selling, assigning, concealing, encumbering, transferring or otherwise disposing of or affecting any of said property and assets.

"It is further ordered that each receiver or receivers heretofore appointed by any State Court in the States of Ohio, Indiana, Illinois, Wisconsin, Kentucky, Tennessee, New York and Pennsylvania be and they are hereby directed to surrender and deliver to said trustee all of the property and assets of the debtor, of whatsoever nature and wheresoever situate, now in their possession and control; and each of said receivers is hereby enjoined and restrained from in anywise interfering with the exclusive possession and control of said trustee of said property and assets of said debtor and from selling, assigning, concealing, encumbering, transferring or otherwise disposing of or affecting any of said property and assets of said trustee."

Whereupon the said portions of said order of June 6, 1941, shall be and become and they are hereby declared to be null, void and of no effect; and it is further ordered that in lieu of said language there be inserted in said order of June 6, 1941, the following:

"It is further ordered that the receivers, H. Isaiah Smith and Ross B. Thomas, heretofore appointed by the Circuit Court of Kanawha County, West Virginia, of the property and assets of said debtor situate in the State of West Virginia, be and hereby are directed and ordered to surrender and deliver to said trustee all of the property, assets and business of the debtor, of whatsoever nature and wheresoever situated, now in their possession and control except such property as was on April 11, 1941, in possession custody or control of any state official, whether the same be in the form of stocks, bonds, debentures, money or other

form, for the purpose of securing the creditors or contract holders of the said Fidelity Assurance Association, Fidelity Investment Association or Fidelity Investment Loan Association against loss occasioned by default in the payment of the amounts payable under said contracts, or for any other purpose; and it is further ordered that said Receivers and their agents and employees, are hereby enjoined and restrained from selling, assigning, concealing, encumbering, transferring or otherwise disposing of or affecting any property of said Debtor without exception whether hereinabove mentioned or not.

"It is further ordered that each receiver or receivers heretofore appointed by any State Court in the State of Ohio, Indiana, Illinois, Wisconsin, Kentucky, Tennessee, New York and Pennsylvania be and they are hereby directed to surrender and deliver to said trustee all of the property and assets of the debtor, of whatsoever nature and wheresoever situate, now in their possession and control except such property on April 11, 1941, in the possession, custody or control of any state official, whether the same be in the form of stocks, bonds, debentures, money or other form, for the purpose of securing the creditors or contract holders of the said Fidelity Assurance Association, Fidelity Investment Association or Fidelity Investment Loan Association against loss occasioned by default in the payment of the amounts payable under said contracts, or for any other purpose; and it is further ordered that each of said Receivers and their agents and employees, are hereby enjoined and restrained from selling, assigning, concealing, encumbering, transferring or otherwise disposing of or affecting any property of said Debtor without exception whether hereinabove mentioned or not."

And it is further ordered that said modification of said order of June 6, 1941, be and it is made *nunc pro tunc* as of the date upon which said order was originally made and entered herein; and

It is further ordered that as modified said order of June 6, 1941, shall read as follows:

(At a District Court of the United States for the Southern District of West Virginia, at Charleston, in said District, on June 6, 1941.)

In the Matter of FIDELITY ASSURANCE ASSOCIATION, Debtor

In Proceedings for Corporate Reorganization

No. 4514

Order Approving Debtor's Petition

This day came Fidelity Assurance Association, by James R. Fleming, its attorney, and presented its verified petition for its reorganization under chapter 10 of the Federal Bankruptcy Act; and it appearing from said petition that the debtor is unable to meet its debts as they mature, and that the debtor desires to effect a reorganization under said corporate reorganization Act, and that it is not a municipal, banking, insurance nor railroad corporation, nor a building and loan association, but is a corporation that could become [fol. 193] a bankrupt under section 4 of the Bankruptcy Act, and has its principal assets in this district; and the Judge being satisfied that said petition of said debtor complies with said chapter 10 of the Bankruptcy Act, and has been filed in good faith:

Now, upon motion of James R. Fleming, the attorney for the petitioner, it is ordered, adjudged and decreed that the said petition be and it is hereby approved as properly filed under said chapter 10 of the Bankruptcy Act, and it is hereby determined that said petition has been filed in good faith.

It is further ordered that Central Trust Co., a corporation, of Charleston, be and hereby is appointed trustee of and for the debtor and its estate, including all of its property and assets, of whatsoever kind and description and wheresoever situated.

It is further ordered that said trustee give a bond to the United States of America in the sum of $50,000.00 for the faithful performance of its duties as such trustee, and that upon the qualification of the trustee and the execution and filing of the bond aforesaid with the Clerk of this Court, said trustee shall take all of the property and assets of said debtor, of whatsoever kind and description and wheresoever situated into his exclusive possession and control, and shall be vested with all the title and rights, subject to the same duties, and shall exercise, subject to the control of the Court and consistently with the provisions of said chap-

ter 10, all the powers of a trustee appointed pursuant to section 44 of the Bankruptcy Act, and such additional rights and powers as a receiver in equity would have if appointed by a Court of the United States for the property of the debtor, and, subject to the authorization and control of this Court, shall carry on, manage, conduct and operate the business of the debtor in its usual course. It is further ordered that the receivers, H. Isaiah Smith and Ross B. Thomas, heretofore appointed by the Circuit Court of Kanawha County, West Virginia, of the property and assets of said debtor situate in the State of West Virginia, be and hereby are directed and ordered to surrender and deliver to said trustee all of the property, assets and business of the debtor, of whatsoever nature and wheresoever situated, now in their possession and control except such property as was on April 11, 1941, in possession, custody or control of any state official, whether the same be in the form of stocks, bonds, debentures, money or other form, for the purpose of securing the creditors or contract holders of the said Fidelity Assurance Association, Fidelity Investment Association or Fidelity Investment Loan Association against loss occasioned by default in the payment of the amounts payable under said contracts, or for any other purpose; and it is further ordered that said Receivers and their agents and employees, are hereby enjoined and restrained from selling, assigning, concealing, encumbering, transferring or otherwise disposing of or affecting any property of said Debtor without exception whether hereinabove mentioned or not.

It is further ordered that each receiver or receivers heretofore appointed by any State Court in the State of Ohio, Indiana, Illinois, Wisconsin, Kentucky, Tennessee, New York and Pennsylvania be and they are hereby directed to surrender and deliver to said trustee all of the property and assets of the debtor, of whatsoever nature and wheresoever situate, now in their possession and control except such property on April 11, 1941, in the possession, custody or control of any state official, whether the same be in the form of stocks, bonds, debentures, money or other form, for the purpose of securing the creditors or contract holders of the said Fidelity Assurance Association, Fidelity Investment Association or Fidelity Investment Loan Association against loss occasioned by default in the payment of the amounts payable under said contracts, or for any other

purpose; and it is further ordered that each of said Receivers and their agents and employees, are hereby enjoined and restrained from selling, assigning, concealing, encumbering, transferring or otherwise disposing of or affecting any property of said Debtor without exception whether hereinabove mentioned or not.

It is further ordered that all creditors and stockholders of debtor and all other persons, firms, associations and corporations, and all persons claiming or acting by, through or under them, including all sheriffs and marshals and other officers, agents, attorneys, solicitors, representatives and employees of them, or any of them, and all receivers of State Courts heretofore or hereafter appointed, or any of them, are hereby enjoined and restrained from instituting, continuing or prosecuting any action at law or suit or proceeding in equity, or any other proceeding, against said debtor or trustee in any court of law or equity or other court or tribunal, or otherwise, and from executing or issuing, or causing, the execution or issuance out of any court, or any public office, of any writ, process, summons, garnishment, attachment, subpoena, replevin, execution or other proceeding for the purpose of examining or taking possession of or interfering with any property constituting the estate of the debtor, or attempting to take into their possession any part of the property constituting such estate, wheresoever situate; and all such persons, firms, associations or corporations are hereby enjoined and restrained from seizing, selling, removing, transferring, disposing of or interfering with, or attempting so to do, any property or assets of said debtor or said trustee, whether or not in their possession or otherwise, and from doing any act or thing whatsoever to interfere with the possession, management and control by said trustee of debtor's assets, property and effects; and all persons, firms and corporations are hereby enjoined and stayed from commencing or continuing any judicial proceeding in any court to enforce any lien or right of any kind or character upon the estate or property of debtor until further order of this Court.

It is further ordered that said trustee is hereby vested with the power, pending further order of this Court, to conduct, manage, maintain, operate and keep in proper condition and repair all of said assets and property of said debtor, and in connection therewith to employ, discharge and

fix the compensation of all agents and employees of the debtor, and to collect and receive all of the income, rents, revenue, issues and profits of said assets and property of said debtor, and to collect all outstanding accounts receivable, and generally to do any act necessary to carry on the business of the debtor, subject to such supervision and control by this Court as by further orders herein it may from time to time exercise.

This Court reserves full right and jurisdiction to make from time to time such orders amplifying, extending, or limiting or otherwise modifying this order as to the Court may at any time seem proper.

Ben Moore, U. S. D. J.

Dated this 6th day of June, 1941.

It is further ordered that as so amended said order shall be deemed to have taken effect and become operative as of June 6, 1941; and

It is further ordered that the order of this Court dated June 10, 1941, be amended by striking therefrom the following language:

"all persons heretofore designated either by name or official position, and all other persons and officials not herein specifically named, who may have in their possession, custody or control, any assets, stocks, bonds, debentures, money, choses in action, real estate, personal property, or property of other kind or character, belonging to said debtor, shall forthwith surrender and deliver all such property to said Trustee; and all said persons and officials are hereby enjoined and restrained from in anywise interfering with the exclusive control and possession by said Trustee of said property and assets of said debtor, and are further enjoined and restrained from selling, assigning, concealing, encumbering, transferring, or otherwise disposing of or affecting any of said property and assets of said debtor.

"It is further ordered and decreed that any and all property heretofore placed in the possession, custody or control of any state official by the Fidelity Assurance Association, the Fidelity Investment Association, or the Fidelity Investment Loan Association, whether the same be in the form of stocks, bonds, debentures, money, or other form, for the purpose of securing the creditors or contract holders of the

said Fidelity Assurance Association, Fidelity Investment Association, or Fidelity Investment Loan Association against loss occasioned by default in the payment of the amounts payable under said contracts, or for any other purpose, is hereby adjudged for the purposes of this order to be assets of the debtor herein and subject to this order."

Whereupon the said portions of said order of June 10, 1941, shall be and become and they are hereby declared to be null, void and of no effect; and it is further ordered that in lieu of said language there be inserted in said order of June 10, 1941, the following:

"all persons heretofore designated either by name or official position, and all other persons and officials not herein specifically named who may have in their possession, custody or control any property of any kind or character heretofore placed in the possession, custody or control of any state official by the Fidelity Assurance Association, the Fidelity Investment Association or the Fidelity Investment Loan Association, whether the same be in the form of stocks, bonds, debentures, money or other form, for the purpose of securing the creditors or contract holders of the said Fidelity Assurance Association, Fidelity Investment Association or Fidelity Investment Loan Association against loss occasioned by default in the payment of the amounts payable under said contracts, or for any other purpose, and their agents and employees, are hereby enjoined and restrained from selling, assigning, concealing, encumbering, transferring or otherwise disposing of or affecting any of said property."

[fol. 194] And it is further ordered that said modification of said order of June 10, 1941, be and it is made *nunc pro tunc* as of the date upon which said order was originally made and entered herein; and

It is further ordered that as modified said order of June 10, 1941, shall read as follows:

(At a District Court of the United States for the Southern District of West Virginia, at Charleston, in said District, on June 10, 1941.)

In Proceedings for Corporate Reorganization

No. 4514

In the Matter of FIDELITY ASSURANCE ASSOCIATION, Debtor

Order Clarifying Authority and Duties of Trustee

This day came the Central Trust Company, heretofore appointed and qualified to act as Trustee for the debtor in this cause and presented to the Court its motion, in writing, moving the Court that the order heretofore entered herein on June 6, 1941, approving the debtor's petition be amended and clarified in that portion thereof pertaining to the delivery of assets of the said Fidelity Assurance Association to the said Trustee.

Upon consideration whereof, and the Court having inspected said written motion, and the said written motion appearing in all respects proper, the same is ordered filed; and it appearing to the Court that good cause is now shown for the amendment of said order, and the Court being of opinion that the said order should be so amended and clarified, it is accordingly adjudged, ordered and decreed that the following named persons and officials, to-wit:

S. Leigh Call, % Gillespie, Burke & Gillespie, 508 Reisch Building, Springfield, Illinois;

Charles R. Fisher, % State Auditor's Office, Des Moines, Iowa;

Richard T. James, Auditor, State of Indiana, Indianapolis, Indiana;

Hon. Richard McIntyre, Special Attorney, State Corporation Commission, Topeka, Kansas;

John A. Lloyd, Division of Insurance, Columbus, Ohio;

Peter F. Hagan and I. H. Krekstein, % Hirschwold, Goff & Rubin, 808-18 North American Building, Broad Street below Chestnut, Philadelphia, Pennsylvania;

Tom B. Wilson and N. J. Lippard, 421 Frick Building, Pittsburgh, Pennsylvania;

Howard L. Smith, % Banking Commission, Madison, Wisconsin;

Dewey S. Godfrey, Suite 525, 705 Olive Street, St. Louis, Missouri;

State Securities Commission, Robert Harris, Secretary, Montgomery, Alabama;

Securities Commissioner, Dover, Delaware;

Secretary of State, Springfield, Illinois;

Commissioner of Insurance, Securities Commission, Indianapolis, Indiana;

Securities Commissioner, Des Moines, Iowa;

Barton Griffith, Receiver, National Bank of Topeka, Kansas, Topeka, Kansas;

Commission of Securities, Securities Division, Topeka, Kansas;

Division of Securities, Frankfort, Kentucky;

Insurance Commissioner, State Insurance Department of Maryland, Baltimore, Maryland;

Securities Commissioner, Jefferson City, Missouri;

Securities Commissioner, Columbus, Ohio;

Pennsylvania Securities Commission, Harrisburg, Pennsylvania;

Commissioner, Department of Insurance and Banking, Nashville, Tennessee;

G. A. Bowles, Commissioner of Insurance, and C. M. Chichester, Director, Securities Division, Richmond, Virginia;

Insurance Commissioner, Charleston, West Virginia;

Securities Commissioner, Madison, Wisconsin;

Securities Commissioner, Tallahassee, Florida,

all persons heretofore designated either by name or official position, and all other persons and officials not herein specifically named who may have in their possession, custody or control any property of any kind or character heretofore placed in the possession, custody or control of any state official by the Fidelity Assurance Association, the Fidelity Investment Association or the Fidelity Investment Loan

Association, whether the same be in the form of stocks, bonds, debentures, money or other form, for the purpose of securing the creditors or contract holders of the said Fidelity Assurance Association, Fidelity Investment Association or Fidelity Investment Loan Association against loss occasioned by default in the payment of the amounts payable under said contracts, or for any other purpose, and their agents and employees, are hereby enjoined and restrained from selling, assigning, concealing, encumbering, transferring or otherwise disposing of or affecting any of said property.

Ben Moore, U. S. D. J.

It is further ordered that this order is not, is not intended to be and shall not be taken to be an adjudication of any of the questions which might have arisen out of such portions of said orders of June 6 and June 10, 1941, or either of them, as by this order are deleted from said orders, respectively, it being the specific purpose of this order to so frame the orders of June 6 and June 10, 1941, and to so dispose of the subject matter thereof as to avoid the necessity of any judicial determination of said questions, or any of them, at this time; and

It is further ordered that except as hereby modified, said orders of June 6, 1941, and June 10, 1941, shall be and are and shall continue in effect as entered; and

It is further ordered that this Court reserves jurisdiction to enter at any time an order or orders amending, modifying, altering, vacating or revoking this order and said orders of June 6, 1941, and June 10, 1941, or any of them.

Edgar B. Sims, Auditor, etc., State of West Virginia, and Ross B. Thomas and H. Isaiah Smith, West Virginia state court receivers, object and except to the entry of said "order modifying orders of June 6 and June 10, 1941," insofar as it affects them on the ground that the Court is without jurisdiction so to order and it is improperly and unlawfully an order by the Court to and against the State of West Virginia and the officials legally representing said state and its officers and agents; further that said West Virginia state court receivers were not invited to attend said informal conference of July 9, 1941, and were not present in person or by attorney thereat; and further that the status quo of the various funds mentioned in said order should only be

preserved if the Court has jurisdiction thereof after there is returned to the West Virginia State Court Receivers the funds turned over by them to the Trustee under protest by virtue of the original orders of the Court entered on June 6, June 10 and June 14, 1941.

And it is further ordered that the injunctive provisions of this order and of the orders referred to herein are not intended to and shall not be deemed to and do not prevent the official depositaries of the several states from collecting income accrued and currently accruing on the securities in their possession, custody or control.

Ben Moore, U. S. D. J.

August 9, 1941.

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[fol. 195] In United States District Court

[Title omitted]

Motion for Order Modifying Orders of June 6, 1941 and June 10, 1941—Filed August 9, 1941

The petition of Central Trust Company, heretofore appointed Trustee herein, respectfully shows:

1. That under date of June 6, 1941 an Order Approving Debtor's Petition was entered herein, wherein, among other things, the receivers, Isaiah Smith and Ross B. Thomas, heretofore appointed by the Circuit Court of Kanawha County, West Virginia, of the property and assets of said debtor situate in the State of West Virginia, and the receivers appointed by any state court in Ohio, Indiana, Illinois, Wisconsin, Kentucky, Tennessee, New York and Pennsylvania were directed and ordered to surrender and deliver to said Trustee all of the property, assets and business of the debtor, of whatsoever nature and wheresoever situated, now in their possession and control, and said receivers and their agents and employees were enjoined from in anywise interfering with the exclusive possession and control of said Trustee of said property and assets of said debtor and said state receivers were enjoined from selling, assigning, concealing, encumbering, transferring or otherwise disposing of or affecting any of said property and assets.

2. That in said order of June 6, 1941 the Court reserved full right and jurisdiction to make from time to time such orders, amplifying, extending, or limiting or otherwise modifying said order, as to the Court might at any time seem proper.

3. That under date of June 10, 1941, upon motion of Central Trust Company, an Order Clarifying Authority and Duties of Trustee was entered herein, which Order named certain persons and officials of various states and ordered that said persons or officials therein designated and all other persons or officials not specifically named therein who may have in their possession custody and control any assets [fol. 196] of said debtor should forthwith surrender and deliver all such property to said Trustee, and enjoining said persons and officials from in any way interfering with the exclusive control and possession of said property and assets of said debtor. It was further ordered by said Order of June 10, 1941, that any and all property theretofore placed in custody or control of any state official by Fidelity Assurance Association, Fidelity Investment Association or Fidelity Investment Loan Association for the purpose of securing the creditors or contract holders thereof against loss occasioned by default in the payment of the amounts payable under said contracts, or for any other purpose, was thereby adjudged for the purposes of said Order to be assets of the debtor herein and subject to said Order.

4. That questions have arisen between the Trustee herein and the various stated, state officials and state receivers mentioned in said Orders of June 6, 1941 and June 10, 1941, as to whether said Orders are valid, as to the jurisdiction of the Court herein over the assets in the hands of said states, state officials and state receivers, as to the jurisdiction of the Court to entertain the petition filed by the debtor herein, as to conflicts in the jurisdiction of the various states, state officials, state receivers and state courts with the jurisdiction of the court herein, and as to other matters, and said states, state officials and state receivers have not turned over the assets in their possession as ordered in said Orders.

5. That on July 9, 1941, an informal conference was called by this Court between the Trustee and its counsel and the persons referred to in said orders of June 6, 1941 and June

10, 1941, insofar as said persons could be identified at that time. Said conference was duly held in the courtroom of this Court at two o'clock in the afternoon on July 9, 1941, and was attended by the following, who noted their appearances thereat:

Hardie Scott, Harrisburg, Pennsylvania; Alexander N. Rubin, Philadelphia, Pennsylvania; Earl B. Swarner, Topeka, Kansas; R. H. Lauritzen, Madison, Wisconsin; H. Vernon Eney, Baltimore, Maryland; Guy B. Brown, Baltimore, Maryland; John H. Coppage, Baltimore, Maryland; J. Ross Crabbe, Columbus, Ohio; Dewey S. Godfrey, St. Louis, Missouri; W. F. Murrell, Jefferson City, Missouri; [fol. 197] R. K. Schurr, St. Louis, Missouri; Dale Dunifon, Columbus, Ohio; David M. Spriggs, Columbus, Ohio; John T. Jarecki, Springfield, *Chicago;* Chas. T. Houston, Nashville, Tennessee; W. F. Gray, Springfield, Illinois; Natt Tipton, Nashville, Tennessee; M. G. Robinson, Indianapolis, Indiana; Raymond Huwe, Cincinnati, Ohio; John J. Rivers, Cincinnati, Ohio; Fyke Farmer, Nashville, Tennessee; J. N. Reinhardt, Washington, D. C.; Ira J. Partlow, Charleston, West Virginia.

6. That conference was called for the purpose of discussing the various questions referred to in paragraph 4 hereof and said questions were fully discussed at said conference by all the parties above named, in an effort to arrive at a practical method of promoting cooperation between the parties in the administration of the estate of the debtor.

It was suggested at that conference that it is unnecessary at the present time to withdraw the property heretofore deposited by the debtor herein with state depositories in the various states in which the debtor's contracts were sold and that this proceeding can be conducted in an orderly fashion if said property is permitted temporarily to remain where it was physically located on June 6 and June 10, 1941, respectively, subject to the order of this court preventing and enjoining any act or conduct with respect thereto which would have the effect of altering the status which said property occupied on June 6, 1941. On that assumption said states state officials and state receivers expressed their willingness, pending the determination of the questions referred to in paragraph 4 hereof, to abide by said orders of June 6, 1941 and June 10, 1941, to the extent that said states state officials and state receivers will re-

frain from selling, assigning, concealing, encumbering, transferring or otherwise disposing of or affecting any of the property now in their possession, control or custody, and said states state officials and state receivers agreed to accede to and carry out promptly any reasonable suggestions directed to them by said Trustee as to the liquidation, investment, reinvestment or other disposition of any such property now in their possession, control or custody, insofar as permitted by state law and the state courts, to the end that such assets may be preserved during the pendency of the proceedings herein and pending the determination of the legal questions referred to in paragraph 4 hereof. In view of this agreement by the said parties, your petitioner [fol. 198] submits that it is not necessary at the present time for the Court to determine the disputed questions raised by the aforesaid orders of June 6 and June 10, 1941.

7. That your petitioner, the Trustee herein, is of the belief that substantial economy in the administration of this estate may be accomplished if the aforesaid questions are not litigated at this time and that this objective can be accomplished without jeopardizing in any way the preservation of the assets of the estate herein and of the interests of the various parties interested therein, provided the orders of June 6 and June 10, 1941 remain in full force and effect, except insofar as said Orders provide for the surrender and delivery to the Trustee of assets in possession and control of said states, state officials or receivers, insofar as said orders provide for enjoining and restraining said states, state officials and state receivers from interfering with the exclusive possession and control of said Trustee over said assets, and insofar as said orders order and decree that any and all property theretofore placed in the possession, custody or control of any state official by the Fidelity Assurance Association, the Fidelity Investment Association or the Fidelity Investment Loan Association for the purpose of securing the creditors or contract holders of said Fidelity Assurance Association, Fidelity Investment Association or Fidelity Investment Loan Association against loss occasioned by default in the payment of the amounts payable under said contracts, or for any other purpose, are adjudged for the purposes of said orders to be assets of the debtor herein and subject to said Orders, and provided that any modification of the order of this Court in the respects recommended herein continues in ef-

fect only until it appears necessary to determine the questions disposed of by said portions of said orders.

Wherefore, your petitioner respectfully prays the entry of an order on the form next hereto.

Respectfully, Central Trust Company. By Counsel: Townsend & Townsend.

Dated August 9, 1941.

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[fol. 199] IN UNITED STATES DISTRICT COURT

[Title omitted]

ORDER FILING ANSWERS—August 9, 1941

This day came Chas. R. Fischer, Commissioner of Insurance and Permanent Receiver for debtor corporation in and for the State of Iowa, and Guy R. Shaw, by their attorneys, Carl J. Stephens and Ben C. Buckingham, and presented their separate answers to the petition of the debtor filed herein on June 6, 1941, which answers are hereby ordered filed.

This order having been inadvertently omitted from the record on August 4, 1941, is entered nunc pro tunc.

Enter:

Ben Moore, District Judge.

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(The Answers, referred to in the foregoing order, are in the words and figures as follows:)

[fol. 200] IN UNITED STATES DISTRICT COURT

[Title omitted]

ANSWER—Filed August 9, 1941

To The Honorable Ben Moore, Judge Of The District Court Of The United States For The Southern District Of West Virginia:

Comes now Chas. R. Fischer, Commissioner of Insurance and Permanent Receiver for debtor corporation in and for the State of Iowa, in the above entitled matter, by his attorneys Carl J. Stephens and Ben C. Buckingham, and for

his answer to the petition of the debtor filed herein June 6, 1941, alleges as follows:

First Defense.

In answer to debtor's petition Chas. R. Fischer, Commissioner of Insurance and Permanent Receiver for debtor corporation in and for the State of Iowa, denies each and every allegation of said petition, except as hereinafter admitted.

1. In answer to paragraph I of debtor's petition, Chas. R. Fischer, Commissioner of Insurance and Permanent Receiver for debtor corporation for the State of Iowa, alleges that said debtor on the date of said petition was in a state of dissolution in the State of West Virginia, the original domicile of said corporation, and was and is at present without license to do business of any nature whatever in the State of West Virginia; that said debtor was on the date of filing said petition and is presently without license to do business of any nature in the State of Iowa, and that said debtor does not exist as a corporation which may file a petition under Chapter X of the Bankruptcy Act.

[fol. 201] 2. In answering paragraph II of debtor's petition, Chas. R. Fischer, Commissioner of Insurance and Permanent Receiver for debtor corporation for the State of Iowa, alleges that said debtor was in a number of states in which it did business, licensed as an insurance company, in other states it was licensed as a building and loan association and was in the State of Iowa subject to statutory supervision and control in a manner similar to a foreign building and loan association, and that by reason of the charter of said debtor corporation, nature of its business, and nature of the licensing and control of said debtor in the states in which it operated, said debtor is entirely without the scope of Chapter X of the Bankruptcy Act.

3. In answering paragraph III of debtor's petition, Chas. R. Fischer, Commissioner of Insurance and Permanent Receiver for debtor corporation for the state of Iowa, admits that said debtor at the time of filing said petition was not licensed to sell investment or annuity contracts, and alleges that said debtor was, on the last date prior to the filing of said petition, when it had any corporate existence,

powers or license, licensed in the State of West Virginia, the state of its domicile, as a life insurance company.

4. In answering paragraph V of debtor's petition, Chas. R. Fischer, Commissioner of Insurance and Permanent Receiver for debtor corporation for the State of Iowa, alleges that debtor, prior to the filing of said petition, had been divested by reason of the operation of state laws in the states in which said debtor operated of substantially all its assets.

5. In answering paragraph VI of debtor's petition, Chas. R. Fischer, Commissioner of Insurance and Permanent Receiver for debtor corporation for the State of Iowa, admits the allegations relative to the appointment of receivers for debtor corporation in Kanawha County, West Virginia at the suit of Edgar B. Sims, Auditor of State of West Virginia and ex-officio Insurance Commissioner of the State of West Virginia; Chas. R. Fischer alleges that as Commis- [fol. 202] sioner of Insurance in and for the State of Iowa he has had custody and control of the assets of the debtor corporation for some years last past, and that as Permanent Receiver he took possession and control of said assets on the 19th day of May, A. D., 1941, and has proceeded, as Permanent Receiver, pursuant to the orders of the District Court, in and for Polk County, Iowa, and the statutes of the State of Iowa.

6. In answering paragraph VII of debtor's petition, Chas R. Fischer, Commissioner of Insurance and Permanent Receiver for debtor corporation for the State of Iowa, admits that said debtor corporation has outstanding certain investment and annuity contracts and admits that said debtor has been and will continue to be unable to meet its obligations as they mature, and alleges that such inability to meet its current obligations is due mainly to mismanagement and dissipation of its assets on the part of said debtor and/or its stockholders, officers and directors and its failure to comply with and meet the standards of state laws which were designed to safeguard the interests of purchasers of debtor's contracts; that said debtor has lost its license to do business in the State of Iowa, and that said debtor will be wholly unable to modify the contracts of said debtor held by residents of the State of Iowa, said contractholders being entitled to look to the deposits made by said debtor in the

State of Iowa in accordance with the statutes of the State of Iowa for the payment of the amounts due on said contracts without modification thereof.

7. In answering paragraph IX of debtor's petition, Chas. R. Fischer, Commissioner of Insurance and Permanent Receiver for debtor corporation for the State of Iowa, alleges that debtor is not a corporation which might lawfully form or effect a plan of reorganization under Chapter X of the Bankruptcy Act.

8. In answering paragraph X of debtor's petition, Chas. B. Fischer, Commissioner of Insurance and Permanent [fol. 203] Receiver for debtor corporation for the State of Iowa, alleges that no action on the part of the Board of Directors of debtor, or any other corporate action on the part of said debtor, could lawfully authorize the filing of a petition by said debtor under Chapter X of the Bankruptcy Act.

Second Defense

Further answering the petition of the debtor herein, and in addition to its foregoing admissions and denials of the allegations, Chas. R. Fischer, Commissioner of Insurance and Permanent Receiver for debtor corporation in and for the State of Iowa, alleges:

1. That the debtor corporation is not entitled to the relief demanded as against Chas. R. Fischer, Commissioner of Insurance and Permanent Receiver for debtor corporation for the State of Iowa, or anyone else similarly situated, for the reason that the securities (bonds) which have been deposited in Iowa for the protection of the contract purchasers of the debtor corporation are now under the custody and control of Chas. R. Fischer, Commissioner of Insurance and Permanent Receiver of the debtor corporation, and the District Court in and for Polk County, Iowa, and are bearer bonds and have had their situs in the State of Iowa since said dates of their deposit, to-wit: January 16, 1929; April 14, 1936; November 2, 1938; that said bonds were deposited according to the statutes of the State of Iowa as contained in the 1927 and subsequent Codes of the State of Iowa; that said bonds have at all times been held by the State of Iowa in trust for the use and benefit of the contractholders (creditors); that the District Court, in and

for Polk County, Iowa, specifically found that the title to said securities vested in the State for the use and benefit of contract purchasers residing in the State of Iowa at the moment said securities were deposited in this state by said debtor corporation; that, therefore, title to said bonds was not in said debtor corporation at the time said debtor filed its petition for reorganization.

2. That said debtor's petition filed June 6, 1941, was not filed in good faith as required by Chapter X of the Bank-[fol. 204] ruptcy Act, in that among other things it is wholly unreasonable to expect that a plan of reorganization can be effected herein and in that prior proceedings are pending in the courts of the State of Iowa and in the courts of other states in which proceedings the interests of Iowa creditors and creditors resident in other states would be best subserved.

3. That the stockholders of debtor have no equity or interest whatever remaining in the business, property or assets of said debtor, the contractholders of said debtor constituting the only remaining interest in the business, property and assets of said debtor, and said stockholders have no legitimate interest whatever to be served by the maintenance of this proceeding and that the maintenance of this proceeding can result only to the detriment of the contract holders of debtor located in Iowa and elsewhere.

4. That the contract holders of said debtor located in Iowa are presently protected to the full extent of the value of the contracts held by them by funds deposited in Iowa by said debtor, title to which funds is now in Chas. R. Fischer, Commissioner of Insurance and Permanent Receiver, and which funds will soon be ready for distribution to said Iowa contractholders.

5. That the petition herein was filed at the instance of persons who are in the position of mere interlopers and who have no interest whatever in the business, property or assets of said debtor and the filing of said petition constitutes an attempt to harass, hinder and delay the efforts of contractholders to realize the value of their contracts according to their rights under laws expressly adapted to such purpose, is in derogation of the very laws under which

debtor operated and obtained its business and revenues during its business career, and is a gross misuse and perversion of the jurisdiction granted to the courts by Chapter X of the Bankruptcy Act.

6. That to the knowledge of Chas. R. Fischer, Commissioner of Insurance and Permanent Receiver for debtor corporation for the State of Iowa, the contractholders of said debtor resident in Iowa are desirous that the funds [fol. 205] deposited by debtor in Iowa in trust for the benefit and security of Iowa contractholders should be liquidated and paid out and that a large number of contractholders have urgently requested that these funds be so paid out to them, and, in view of the history of said debtor in Iowa and its failure to meet its obligations, said contractholders are no longer willing to carry their contracts with said debtor either as presently constituted or upon any proposed reorganization, and said Chas. R. Fischer, Commissioner of Insurance and Permanent Receiver for debtor corporation for the State of Iowa, is informed and verily believes that said contractholders will not consent to any plan of reorganization whatever involving said debtor.

7. That an examination of the terms of the various contracts which debtor has outstanding which include provisions relative to cash value, paid up contract value, options, reserve funds, maturity and retirement funds, surplus participation, cash commuted value, insurance protection features, and many other diverse and complex provisions illustrates that insurmountable difficulties would be presented in attempting to modify all of the various classes of contracts outstanding and to secure the consent of the requisite number of contractholders thereof, and demonstrates conclusively that a reorganization of the debtor is not feasible.

8. That although all of the facts alleged in this answer were well known to the debtor at the time said petition was filed, and said debtor has for a period of some years been well aware that it would be unable to meet its contract obligations, yet said debtor has wholly failed to file or suggest any plan of reorganization up to the present time and has given no indication whatever as to when such a plan may be forthcoming, and that the failure of debtor in this re-

spect under the circumstances existent demonstrates conclusively its lack of good faith in the filing of said petition. [fol. 206] Wherefore, Chas. R. Fischer, Commissioner of Insurance and Permanent Receiver for debtor corporation for the State of Iowa, prays that the petition of said debtor be dismissed at debtor's costs.

Commissioner of Insurance and Permanent Receiver for the Debtor Corporation for State of Iowa, by (S.) Chas. R. Fischer, Commissioner and Permanent Receiver. (S.) Carl J. Stephens, (S). Ben C. Buckingham, Attorneys for Permanent Receiver.

Dated this 1st day of August, 1941.

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[fols. 207-214] *Duly sworn to by Chas. R. Fischer. Jurat omitted in printing.*

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[fol. 215] In United States District Court

[Title omitted]

Motion to Vacate or Rescind Order of August 9, 1941, in so Far as Same is Applicable to Insurance Commissioner of Maryland—Filed September 12, 1941

Now comes John B. Gontrum, Insurance Commissioner of the State of Maryland, appearing specially and for the sole purpose of prosecuting this Motion, and moves this Honorable Court to vacate or rescind its order entered herein on August 9, 1941, in so far as the same purports to enjoin and restrain this Movant from selling, assigning, concealing, encumbering, transferring or otherwise disposing of or affecting any of the securities heretofore assigned to and deposited with the Insurance Commissioner of the State of Maryland by the Debtor. And for cause of his said motion, this Movant says that this Honorable Court is without jurisdiction to enjoin and restrain this Movant from selling, assigning, concealing, encumbering, transferring or otherwise disposing of or affecting the securities heretofore assigned to and deposited with the Insurance Commissioner of the State of Maryland by the Debtor, because:

1. The securities heretofore assigned to and deposited with the Insurance Commissioner of the State of Maryland by the Debtor were so assigned and deposited in accordance with the laws of the State of Maryland, Sections 218 to 234, inclusive, of Article 48A of the Code of Public General Laws of Maryland, and the said securities are now, under the laws of the State of Maryland, in the custody and possession of, and title thereto is now vested in this Movant as Insurance Commissioner of the State of Maryland. As Insurance Commissioner of the State of Maryland this Movant is the mere agent of the State of Maryland and in his capacity as such, is beyond the reach of the judicial power of this Honorable Court. The State of * * * Maryland has not [fol. 216] given its consent to a suit, injunction or other judicial proceeding against this Movant as Insurance Commissioner of the State of Maryland, and the order of this Honorable Court entered herein on August 9, 1941, in so far as it is directed against and purports to enjoin and restrain this Movant as Insurance Commissioner of the State of Maryland, is, therefore, void under the Eleventh Amendment to the Constitution of the United States.

2. The laws of the State of Maryland, Sections 218 to 234, inclusive, of Article 48A of the Code of Public General Laws of Maryland under which the Debtor was required to and did assign to and deposit with the Insurance Commissioner of the State of Maryland the securities now held by this Movant, were enacted by the State of Maryland for the better protection of its citizens in the exercise of the powers reserved to it as a sovereign state by the Tenth Amendment to the Constitution of the United States, and said laws of the State of Maryland provide a complete and comprehensive plan or method for liquidating said securities and distributing the proceeds thereof among the persons entitled thereto under the laws of the State of Maryland. The Bankruptcy Laws of the United States cannot and do not infringe upon, supersede or abrogate such laws of the State of Maryland and; therefore, this Honorable Court has no jurisdiction under any supposed authority conferred by the Bankruptcy Act to enjoin and restrain this Movant as Insurance Commissioner of the State of Maryland from disposing of such securities and distributing the proceeds thereof in accordance with the laws of the State of Maryland.

3. The securities heretofore assigned to and deposited with the Insurance Commissioner of the State of Maryland by the Debtor do not constitute property of the Debtor within the meaning of Chapter 10 of the Bankruptcy Act so as to give this Honorable Court jurisdiction over such securities.

4. It does not appear from the petition filed herein by the Central Trust Company, Trustee, upon which the said order of August 9, 1941, was entered, that the Debtor has any equity in the said securities heretofore assigned to and deposited with the Insurance Commissioner of the State of Maryland by the Debtor, or that the present value of said securities is in excess of the obligations of the Debtor on contracts heretofore sold, negotiated, issued or accrued in the State of Maryland, and, therefore, the said securities [fol. 217] do not constitute property of the Debtor within the meaning of Chapter 10 of the Bankruptcy Act so as to give this Honorable Court jurisdiction over such securities.

5. This Movant is informed and believes that the Debtor has no equity in the said securities heretofore assigned to and deposited with the Insurance Commissioner of the State of Maryland by the Debtor, and is informed and believes that the present value of said securities is less than the obligations of the Debtor on contracts heretofore sold, negotiated, issued or accrued in the State of Maryland; and, therefore, the said securities do not constitute property of the Debtor within the meaning of Chapter 10 of the Bankruptcy Act so as to give this Honorable Court jurisdiction thereover.

6. The securities heretofore assigned to and deposited with the Insurance Commissioner of the State of Maryland by the Debtor were, in accordance with the laws of the State of Maryland, so assigned and deposited and are now held by this Movant in trust as security for all the holders of contracts or other obligations of the Debtor sold, negotiated, issued or accrued in the State of Maryland, and title to said securities, as well as custody and possession thereof are now in this Movant and not in the Debtor. The said securities, therefore, do not constitute property of the Debtor within the meaning of Chapter 10 of the Bankruptcy Act so as to give this Honorable Court exclusive jurisdiction thereover.

7. The securities heretofore assigned to and deposited with the Insurance Commissioner of the State of Maryland by the Debtor, and now held by this Movant as such Insurance Commissioner, were so assigned and deposited in accordance with the laws of the State of Maryland, Sections 218 to 234 of Article 48A of the Code of Public General Laws of Maryland, which provide that said securities should be held by said Insurance Commissioner of the State of Maryland in trust as security for all the holders of contracts of the Debtor sold, negotiated, issued or accrued in the State of Maryland. The assignment and deposit of said securities in accordance with the said laws of the State of Maryland constitute a contract in the public authority within the meaning of Chapter 10 of the Bankruptcy Act, and this Honorable * * * Court is without jurisdiction [fols. 218-220] to reject, alter, modify or abrogate said contract.

(S.) H. Vernon Eney, Guy B. Brown, Attorneys for John B. Gontrum, Insurance Commissioner of the State of Maryland, Appearing Specially and for the Sole Purpose of Prosecuting This Motion.

*Duly sworn to by John B. Gontrum. Jurat omitted in printing.*

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[fol. 221] In United States District Court

[Title omitted]

Motion to Amend Answer—Filed September 15, 1941

Come now the intervenors, Edgar B. Sims, Auditor of the State of West Virginia and ex-officio Insurance Commissioner of the State of West Virginia, and H. Isaiah Smith and Ross B. Thomas, State Court Receivers, by counsel, and move the Court that they be permitted to amend the answer filed by the former and adopted by the latter on page 3 thereof, and Paragraph II, so as to read as follows: "Respondent denies that the debtor is a corporation which could be adjudged a bankrupt under the Federal Bankruptcy Act, and upon information and belief denies that it is not an insurance corporation, and respondent therefore alleges debtor is not authorized to file a petition under the

provisions of the Bankruptcy Act.", in the place of said Paragraph II set out in said answer.

Edgar B. Sims, Auditor of the State of West Virginia and Ex-officio Insurance Commissioner of the State of West Virginia, by (S.) Clarence W. Meadows, by J. C. P., III, Clarence W. Meadows, Attorney General; H. Isaiah Smith and Ross B. Thomas, State Court Receivers, by (S.) J. Campbell Palmer, III, Koontz & Koontz, Their Counsel.

September 15, 1941.

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[fols. 222-223] IN UNITED STATES DISTRICT COURT

[Title omitted]

CONSENT OF DEBTOR TO AMENDMENT OF ANSWER—Filed September 15, 1941

James R. Fleming, counsel for the debtor, Fidelity Assurance Association, upon being requested so to do by attorneys for Edgar B. Sims, Auditor of the State of West Virginia and ex-officio Insurance Commissioner of the State of West Virginia, and H. Isaiah Smith and Ross B. Thomas, State Court Receivers, hereby consents, in writing, in accordance with Rule 15(a) of the Rules of Civil Procedure, to the amendment of Paragraph II, page 3, of the answer filed and adopted by said above mentioned parties, as set out in their written motion of September 15, 1941.

(S.) James R. Fleming, Attorney for Debtor.

September —, 1941.

[fol. 224] IN UNITED STATES DISTRICT COURT

[Title omitted]

MOTION OF L. H. BROOKS, TRUSTEE, FREDERIC LEAKE, AND A. L. GOLDBERG, JR., TRUSTEE, TO VACATE OR RESCIND ORDER OF AUGUST 9, 1941, IN SO FAR AS SAME IS APPLICABLE TO PROCEEDINGS IN TENNESSEE STATE COURT—Filed September 15, 1941

Come L. H. Brooks, Trustee, Frederic Leake, and A. L. Goldberg, Jr., Trustee, appearing specially and for the sole purpose of prosecuting this motion, and move to va-

cate or rescind the order entered August 9, 1941, in so far as same purports to enjoin and restrain these movants from continuing the proceedings in the Chancery Court of Davidson County to enforce the trust in favor of the holders of investment contracts sold by debtor in the State of Tennessee in and to the deposit of securities in the hands of the State Treasurer of Tennessee. For grounds of their said motion movants refer to the certified transcript of the record of said proceedings attached as an exhibit to their answer to debtor's petition and filed as a part of the record in this case, as well as the undisputed facts appearing in [fol. 225] the pleadings and record in the case, and say:

(1) The undisputed facts show that debtor's petition for reorganization, including the application for injunction, was not filed in good faith in that there is no reasonable prospect of a fair, equitable and feasible plan of reorganization of debtor.

(2) The claims of contract holders in Tennessee entitled to the benefit of a deposit of securities in that State are in excess of the amount of the deposit and whether or not a plan of reorganization is ever presented or confirmed, there is no equity in said deposit for debtor or for the Trustee.

(3) The deposit of securities by the debtor in the State of Tennessee was made pursuant to a State statute which required said deposit as a condition to the doing of business in that State by the company and which further prohibits said deposit from being released or returned until the discharge in full of all liabilities of the company on all investment contracts sold in the State of Tennessee and for which such deposit is maintained and an injunction of this Honorable Court in this proceeding staying the enforcement of the rights of the Tennessee contract holders through proceedings instituted in the Courts of that State is contrary to the Tenth and Eleventh Amendments to the Constitution of the United States.

(4) No necessity for a stay of the prosecution of the judicial proceedings in the Courts of Tennessee for the sub-
[fols. 226-228] jection of the deposit in that State to the claims of contract holders entitled to the benefit of the deposit because no plan of reorganization of debtor could

deprive the contract holders entitled to the benefit of the deposit in Tennessee of the option of obtaining cash payment of the liability of the debtor in cash out of said deposited securities.

Wherefore, Movants Pray:

(1) That the order of August 9, 1941, be modified so as to permit the proceedings in the Chancery Court of Davidson County, Tennessee for the subjection of the securities deposited in that State to the claims of contract holders entitled to the benefit of the deposit to be proceeded with and to permit the State Court in that proceeding to determine the rights and interests of said claimants in said deposited securities.

(2) That the Trustee herein be ordered and directed to furnish for use in said proceedings in the State Courts of Tennessee all information and records of the debto. hat may be necessary for the determination of the relative rights of the contract holders in said deposited securities in Tennessee.

(S.) Fyke Farmer, Attorneys for L. H. Brooks, Trustee, Frederick Leake, and A. L. Goldberg, Jr., Trustee.

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[fol. 229] In District Court of the United States

[Title omitted]

Motion of D. C. Rivers, et al., to File Intervening Cross Petition Seeking Reorganization—Filed nunc pro tunc as of August 26, 1941

To the Honorable Ben Moore, Judge of the District Court of the United States for the Southern District of West Virginia:

Now comes D. C. Rivers, Pauline Rivers, etc. (See page 1 of cross petition) and move for leave to intervene with a cross petition in this proceeding, for themselves individually and as members of the Ohio-Indiana and Kentucky creditors committee and as such committee, and on behalf of all other persons similarly situated contract holder creditors of the Fidelity Assurance Association, in order to

assert their right to Chapter X, Section 126, to seek a Reorganization of the debtor corporation through their proposed cross petition, of which a copy is hereto attached and made a part hereof upon the grounds:

1. Set forth on Pages 2, 3, 4, 5, 11 and 12 of the attached proposed cross petition, particularly those stated on the bottom of page 3 and top of page 4 and all of pages 11 and 12;

2. That the hearings provided in Chapter X, Sections 144 and 161, of the Bankruptcy Act are not completed and are pending, and Section 145 provides for filing an answer [fol. 230] after completion of the hearing in Section 144, and therefore a cross petition seeking the Reorganization can be filed within the same period;

3. That a cross petition seeking Reorganization can be filed any time prior to dismissal of the original petition or prior to "an order which has become final approving a petition;" as described in Section 149 of the Act;

4. That the filing of this cross petition will not unduly delay or prejudice the adjudication of the rights of the original parties herein, the debtor, certain creditors and State officials and state court receivers for the reason that the provisions of Section 145 of the Act would justify the Court in refusing to hear evidence upon any issues established by the cross petition which have already been tried and determined, and for the further reason that a plan of Reorganization will not completely have been voted upon by creditors before the statutory time periods provided in Sections 144 and 161 have expired;

5. Congress intended to provide a group of three (3) or more creditors with claims in the aggregate of $5,000 or more, with the remedies of a cross petition to exercise their right created in Section 126 to seek a Reorganization;

6. The application of the principals of equity to the circumstances of this particular case provide creditors with a right to intervene by cross petition to seek a Reorganization.

(S.) Raymond Huwe, 1016 1st Nat'l Bank Bldg., Cincinnati, Ohio. (S.) John J. Rivers, 711 Traction Bldg., Cincinnati, Ohio, Attorneys for D. C. Rivers, et al., Cross Petitioners.

[fol. 231] IN UNITED STATES DISTRICT COURT

[Title omitted]

CROSS-PETITION OF D. C. RIVERS, ET AL., INDIVIDUALLY, AND THE OHIO, INDIANA, AND KENTUCKY CREDITORS COMMITTEE SEEKING REORGANIZATION OF DEBTOR

To the Honorable Ben Moore, Judge of the District Court of the United States for the Southern District of West Virginia:

Now come D. C. Rivers, Pauline Rivers, R. A. McDowell, Arthur C. Burroway, W. Frank Armstrong, William G. Werner, Trustee for Margaret Ann Werner and William Thomas Werner, James E. Traquair, Bela Klein, and Harry J. Gilligan, Trustee for John J. Gilligan, Jeanne Gilligan, Frank J. Gilligan, and Harry J. Gilligan, Jr., Cincinnati, Hamilton County, Ohio, Edward F. Wiederhold, Jr., Lebanon, Warren County, Ohio, Carl H. Krippendorf, Perintown, Clermont County, Ohio, Parke G. Smith, Amberly Village, Hamilton County, Ohio, John J. Rivers, St. Bernard, Hamilton County, Ohio, and Merlin R. Granger, Cincinnati, Hamilton County, Ohio, and Indianapolis, Marion County, Indiana, on behalf of themselves individually and [fol. 232] all other persons similarly situated, contract holders and creditors of The Fidelity Assurance Association, formerly The Fidelity Investment Association, and on behalf of the Ohio, Indiana, and Kentucky Fidelity Assurance Association creditors committee, Cincinnati, Ohio, of more than twelve contract holder creditors, and all other persons similarly situated, who may come in and seek relief herein and say:

They are the owners of cash surrender liability claims ag-inst the debtor which are more than $5,000.00 in aggregate and which claims are liquidated as to amount and not contingent as to liability and are stipulated in the cash surrender schedules of their respective contracts;

That the questions which are the subject matter of these proceedings for corporate reorganization of The Fidelity Assurance Association are of common and general interest to all contract holders of the debtor, irrespective of what states they are residents and of what deposits are held in the respective states in which they reside;

That these cross-petitioners are informed and believe that all of the contract holders and creditors of the debtor are persons constituting a class so numerous as to make it impracticable to bring them all before this court, and these cross-petitioners will fairly insure the adequate representation of all similarly situated persons because the character of the right sought to be enforced for or against this class is

1) Several, and the object of the action is adjudication of claims which may affect specific property involved in [fol. 233] this action, and upon which all of these persons have a claim as cestui qui trust beneficiaries and a lien; and

2) Several, and there are common questions of law and fact affecting the several rights, and a common relief is sought, as provided in Rule 23 of the Federal Rules of Civil Procedure.

These cross-petitioners further state that no other creditors have filed in this proceeding any pleading on behalf of the creditors of the debtor which seeks the reorganization of the debtor by this court and which joins in the prayer of the debtor for reorganization of the debtor.

These cross-petitioners further state

1. That a statute of the United States, to-wit: Section 126 of Chapter X of the Bankruptcy Act (Chandler Act) as amended August 22, 1940, confers upon them an unconditional right to intervene in this proceeding to file a cross-petition seeking the reorganization of the debtor; that said Section of Chapter X does not preclude three or more creditors having claims in the aggregate of $5,000.00 or over from filing a cross-petition seeking a reorganization of the debtor; that Section 137 of the Act provides only for an answer of creditors which controverts and denies the allegations of the original petition and does not provide for a pleading by the creditors joining in the prayer of the petition; that Section 126 of the Act permitting a petition by the required number of creditors, "if no other petition by or against such corporation is pending under this Chapter file a petition under this Chapter" does not preclude these cross-petition creditors from filing a cross-petition under this Chapter joining in the prayer of the [fol. 234] petition; that in the event the original petition

in this pending reorganization proceeding is dismissed for lack of legal capacity of the debtor to file such a petition (more fully set forth in Part VII hereinafter in this cross-petition) these cross-petitioning creditors, if the right to intervene in this proceeding to file a cross-petition is denied, will be required to file a separate petition for reorganization after the present reorganization proceeding ceases to be pending to the prejudice of the debtor, stockholders and creditors of the debtor by reason of a succession of suits for reorganization;

2. That the representation by existing parties to this proceeding of their interest and the interest of all others similarly situated is inadequate as far as the pleadings filed in this matter are concerned in that no other creditors have requested that the debtor be reorganized and join in the prayer of the debtor for reorganization, and the interest of these cross-petitioning creditors and the interest of all others similarly situated is, or may be, bound by a judgment in this action.

These cross-petitioners further state that the above circumstances provide them with the power to intervene in this proceeding as a matter of right, pursuant to Rule 24 (a) of the Federal Rules of Civil Procedure.

In the alternative these cross-petitioners state that if the statutes of the United States, Section 126 of Chapter X of the Bankruptcy Act (Chandler Act) as amended August 22, 1940, do not confer an unconditional right to intervene, they confer a conditional right to intervene under the conditions described as appertaining to Rule 23 and Rule 24 [fol. 235] (b) hereinbefore stated, and further state that their claims and cross-petition have questions of law and fact in common with the main action in this proceeding and state that their intervention by cross-petition will not unduly delay or prejudice the adjudication of the rights of the original parties herein, as required in Rule 24(b).

These cross-petitioning contract holder creditors respectfully represent:

I

That the Fidelity Assurance Association, known prior to January 1, 1941, as The Fidelity Investment Association, is unable to qualify under the Investment Companies Act of 1940 to conduct new business and is insolvent according to market valuations of its assets.

II

Said debtor is a corporation organized under the laws of the State of West Virginia and existed as a bond investment company selling installment face amount certificates, installment annuities and installment saving contracts to the public until December 31, 1940, and was licensed but failed to qualify and operate as an insurance company under the laws of West Virginia until March 31, 1941, and is a corporation which could become bankrupt under Section 4, Act of Congress, relating to bankruptcy, and is not a municipal, insurance, banking nor railroad corporation, nor a building association.

Said debtor now has, and for a longer portion of the six months next preceding the filing of the original petition [fol. 236] and this cross-petition has had, its principal assets in the control of the West Virginia State Treasurer and/or the West Virginia Auditor and Ex-Officio Insurance Commissioner at Charleston, West Virginia, within the territorial jurisdiction of this court, than in any other judicial district.

These cross-petitioners aver that the interests of the debtor in the securities deposited in said judicial district are of an equitable nature and are and were located in said city and district by reason of the fact that the legal title holder of said securities and the trustee of said securities for the primary benefit of all cestui qui trust contract holders wherever residing and for the secondary and resulting trust benefit of the debtor is personally within said city and district, and that said legal title holder and trustee placed said securities, 95% endorsed to bearer, in the vaults of the Kanawha Valley Bank located in Charleston, West Virginia in said judicial district.

These cross-petitioners further aver that under the provisions of Section 3448 (3) of Michie's Code of West Virginia laws the Treasurer of West Virginia and/or Auditor and Ex-Officio Insurance Commissioner of West Virginia is or are trustee or trustees of said securities, 95% of which are endorsed to bearer, for the benefit of all contract holders of the Special Income, Special Annuity, Special Annuity Matured and Retired, Series A, Series A Matured and Retired, Series B, Series B Matured and Retired, Series C, Series D, and Series D Matured and Retired funds of the debtor and that debtor's resulting and secondary

[fol. 237] equity trust interests in said assets have existed within the above named judicial district and that said interests are its principal assets.

III

The nature of the business of said debtor is the sale of installment face amount certificates, installment annuities and installment saving contracts to the public either directly or through a subsidiary and the investment of the installment cash payments of contract holders of many states of the United States in securities.

IV

1. The assets and liabilities of said debtor are set forth in "Exhibit A" of the original petition of said debtor. These cross-petitioners incorporate said Exhibit A by reference and make said Exhibit A of the original petition filed June 6, 1941, by the debtor, a part hereof for the purpose of stating the assets and liabilities as of October 31, 1940. These cross-petitioners further state that the assets and liabilities of the debtor are more recently compiled by The Central Trust Company of Charleston, West Virginia, the duly appointed and qualified trustee in this proceeding, and that parts A to M inclusive of its report filed with the Court on August 5, 1941, are likewise incorporated herein by reference and made a part hereof for the purpose of showing the assets and liabilities of the debtor as of June 6, 1941.

[fol. 238] 2. The issued and outstanding stock of the debtor is set forth in Part IV of the debtor's original petition filed on June 6, 1941. These cross-petitioners adopt in full said Part IV of the debtor's original petition and incorporate it as their statement of the facts relating to the issued and outstanding stock of the debtor and make it a part hereof, the same as if reiterated and rewritten herein.

3. The financial condition of the said debtor is that the market values of its assets are not equal to its liabilities. There is pending in the State of West Virginia a receivership suit filed by the Auditor and Ex-Officio Insurance Commissioner of West Virginia based upon the failure of the debtor's assets to equal its liabilities. There are pending in other states not less than fifteen separate ancillary re-

ceivership proceedings, including that of Wisconsin wherein over $1,000,000 market value of securities of a deposit by debtor of securities of the approximate market value of $2,500,000 have already been converted by the Wisconsin Banking Commission into cash in preparation for distribution to Wisconsin contract holders, and including proceedings in several other states wherein the duly qualified and appointed receivers were preparing to likewise sell securities belonging to the contract holders of the debtor of ten separate trust funds, described in Part III hereinbefore, in which the contract holders of the debtor have an interest.

V

The nature of all pending proceedings affecting the property of said debtor known to your cross-petitioners and the [fol. 239] Courts in which they are pending, is set forth in the last paragraph of Part IV hereof and in Part XII hereof.

VI

No plan of reorganization, readjustment or liquidation affecting the property of said debtor is pending either in connection with or without any judicial proceeding.

VII

The specific facts showing the need for relief under Chapter X of said Act are as follows:

1. The earnings from investments of said debtor required by the laws and rules and regulations of officials of various states in recent years have been insufficient, and the prospective earnings in future years at present appear to be insufficient to enable it to meet its liabilities under its contracts executed with its contract holders;

2. The assets in which the debtor has an interest, to-wit: industrial, financial, railroad, public utility, federal farm loan, municipal, U. S. Government, foreign governmental, foreign corporation, and real estate bonds and mortgage notes and domestic corporation preferred stocks, are of substantial value and will mature in the future at a higher value than their present market values, which on June 6, 1941 approximated $23,640,000. These assets, if preserved and not liquidated or sold at this time, will have a much greater value as assets of a reorganized going concern and

will provide the contract holding creditors of the debtor, if the debtor is reorganized, with a much greater return [fol. 240] to them of their investment and money than if presently liquidated and if hereafter valued upon the current standards established by the National Association of Insurance Commisioners or by the Board of Governors of the Federal Reserve Banking System;

3. The debtor has not qualified to do business under the Investment Company Act of 1940;

4. The debtor is in need of reorganization for the above reasons and cannot successfully effect a reorganization unless under a judicial proceeding in a court with nation-wide jurisdiction.

5. The proposed reorganization by the West Virginia Auditor and Ex-Officio Insurance Commissioner under the West Virginia, Kanawha Circuit Court, became ineffective when that Court's jurisdiction did not include jurisdiction over the officials in fifteen different states holding deposits of the debtor and who could not be enjoined from selling securities deposited by the debtor in which the contract holders had an interest. The only judicial proceeding in which the debtor can be effectively reorganized, in view of the above facts, is the Federal Court with nation-wide jurisdiction to prevent any acts prejudicial to the interest of the contract holders in the debtor's deposits in West Virginia and in all other states.

6. The debtor's good faith and legal capacity to file a petition for reorganization under Chapter X of this Act has been questioned because of the alleged illegal and defective Board of Directors meeting which authorized debtor [fol. 241] company, be resolution, to file said petition. Questions have been raised as to

a) The insufficiency of the contents of the notice of the directors meeting of June 3, 1941;

b) The improper notice of the change of meeting place from Wheeling to Pittsburgh;

c) The incapacity of certain directors who voted on said resolution to serve as directors in view of the injunction proceedings against debtor in Detroit, Michigan, in December, 1938, and the inability of these directors to obtain

exemption from the application of certain rules and regulations of the S. E. C. and provisions of the Investment Company Act of 1940;

d) The legality of the quorum in existence at the time of the resolution at the meeting of June 3, 1941, with reference to the application of the by-laws of the debtor to said quorum.

If the debtor is found by this Court not to have legal capacity to file said petition under Chapter X of said Act, then this petition and this proceeding in reorganization may be dismissed and the administration of the debtor's assets will be returned to the West Virginia, Kanawha Circuit Court, and the fifteen other state courts in which receiverships are pending to the prejudice of the contract holders with beneficial interest in the ten separate trust funds of the debtor.

The other alternative to the last above mentioned situation would be a creditors' petition under Section 126 of said Act to be filed immediately after the dismissal of this pending reorganization proceeding. All of the evidence and [fol. 242] hearings upon motions, pleadings, etc. of this pending reorganization proceeding and all of the trustees' reports herein, would be of no avail in a subsequent proceeding by creditors after the dismissal of this proceeding. There would be duplication in costs and loss of valuable time, to the prejudice of the contract holder creditors.

For the above stated reasons these cross-petitioners file this cross-petition under Section 126 of Chapter X of said Act for the purposes of avoiding liquidation by fifteen different state ancillary receivers and of eliminating the necessity of a creditors' petition after this pending reorganization proceeding is dismissed because of the lack of legal capacity of the debtor to file a petition by reason of any alleged defects of the meeting of June 3, 1941. The interest of said debtor and its contract holders will be best preserved by the continuance of its business as a going concern under a plan of reorganization which can be accomplished under the provisions of Chapter X of said Act.

7. The specific facts showing why adequate relief cannot be obtained under Chapter XI of said Act are as follows:

The capital structure of said debtor must be revised and the interest payments of the contracts of said debtor must

be adjusted and reduced and contractural reserve provisions revised.

VIII

Your cross-petitioners desire that a plan of reorganization be effected for said debtor under and pursuant to Chapter X of said Act.

[fol. 243] The Investors Syndicate, a Minnesota corporation, and a competitor of the debtor, has qualified under the provisions of the Investment Company Act of 1940 and the wholly owned subsidiary of the debtor, Fidel Association of New York, incorporated, has always met the stringent requirements of the laws of New York and Connecticut and the regulatory control of their state officials, and these cross-petitioners believe that a plan of reorganization is reasonable which may be similar to the organization of any competitor now qualifying and operating under provisions of the Investment Company Act of 1940.

IX

The indebtedness of said debtor, liquidated as to amount and not contingent as to liability, is over $250,000.

X

No other reorganization proceeding is pending against said debtor under Chapter X of said Act except this proceeding in which this cross-petition is filed, nor is any other bankruptcy proceeding, initiated by a petition, by or against said debtor now pending.

XI

Your cross-petitioners are contract holder creditors of said debtor and have claims against it and against its securities and property, liquidated as to amount and not contingent as to liability by reason of their cash surrender liability claims, stipulated by the terms of their contracts [fol. 244] with the debtor, amounting in the aggregate to over $5,000, in fact in the exact total amount of $10,069.15.

The nature and amount of cross-petitioners' claims, for the purposes of this cross-petition, are as follows:

(1) The claim of cross-petitioners, D. C. Rivers and/or Pauline Rivers is for the sum of $1407.50. The said cross-petitioners are the owners of a Series D contract of the

debtor, No. 35-5V175, registered June 11, 1937, and the cash surrender liability claim of said cross-petitioners is stipulated by said contract to be $1407.50 or more.

(2) The claim of cross-petitioner, R. A. McDowell, is for the sum of $348.00. The said cross-petitioner is the owner of a Series D contract of the debtor, No. 35-5S4411, registered September, 1938, and the cash surrender liability claim of said cross-petitioner is stipulated by said contract to be $348.00 or more.

(3) The claim of cross-petitioner, Arthur C. Burroway, is for the sum of $181.50. The said cross-petitioner is the owner of a Series D contract of the debtor, No. 35-5R-5988, registered July 19, 1938, and the cash surrender liability claim of said cross-petitioner is stipulated by said contract to be $181.50 or more.

(4) The claim of cross-petitioner W. Frank Armstrong, is for the sum of $645.00. The said cross-petitioner is the owner of a Series D contract of the debtor, No. 35-5S-740, registered October, 1936, and the cash surrender liability claim of said cross-petitioner is stipulated by said contract to be $645.00 or more.

(5) The claim of cross-petitioner Edward F. Wiederhold, Jr., is *the* for the sum of $69.00. The said cross-petitioner is the owner of a Series D contract of the debtor, No. 35-R-7328, registered November 25, 1938, and the cash surrender liability claim of said cross-petitioner is stipulated by said contract to be $69.00 or more.

[fol. 245] (6) The claim of cross-petitioner, Carl H. Krippendorf, is for the sum of $720.00. The said cross-petitioner is the owner of a Series D contract of the debtor, No. 35-5U-745, registered August 18, 1938, and the cash surrender liability claim of said cross-petitioner is stipulated by said contract to be $720.00 or more.

(7) The claim of cross-petitioner, Carl H. Krippendorf, is for the sum of $720.00. The said cross-petitioner is the owner of a Series D contract of the debtor, No. 35-5U-746, registered August 18, 1938, and the cash surrender liability claim of said cross-petitioner is stipulated by said contract to be $720.00 or more.

(8) The claim of cross-petitioners, William G. Werner, and/or Margaret B. Werner, Trustees for Margaret Ann

Werner and Wm. Thomas Werner, is for the sum of $2195.00. The said cross-petitioners are the owners of a Series D contract of the debtor, No. 35-5W-126, registered October 26, 1938, and the cash surrender liability claim of said cross-petitioners is stipulated by said contract to be $2195.00 or more.

(9) The claim of cross-petitioners, James E. Traquair and/or Betty O. Traquair, is for the sum of $159.00. The said cross-petitioners are the owners of a Series D contract of the debtor, No. 35-5R-6682, registered October 1, 1938, and the cash surrender liability claim of said cross-petitioners is stipulated by said contract to be $159.00 or more.

(10) The claim of cross-petitioner, John J. Rivers, is for the sum of $266.00. The said cross-petitioner is the owner of a Series D contract of the debtor, No. 35-5R-1228, registered November 20, 1936, and the cash surrender liability claim of said cross-petitioner is stipulated by said contract to be $266.00 or more.

(11) The claim of cross-petitioner, Merlin R. Granger, is for the sum of $810.00. The said cross-petitioner is the owner of a Series D contract of the debtor, No. 35-5S-798, registered October 20, 1936, and the cash surrender liability claim of said cross-petitioner is stipulated by said contract to be $810.00 or more.

(12) The claim of cross-petitioner, Merlin R. Granger, is for the sum of $458.50. The said cross-petitioner is the owner of a Series B contract of the debtor, No. 34-S-13649, registered November 10, 1937, and the cash surrender [fol. 246] liability claim of said cross-petitioner is stipulated by said contract to be $458.50 or more.

(13) The claim of cross-petitioner, Merlin R. Granger, is for the sum of $131.00. The said cross-petitioner is the owner of a Series B contract of the debtor, No. 34-S-22807, registered October 6, 1939, and the cash surrender liability claim of said cross-petitioner is stipulated by said contract to be $131.00 or more.

(14) The claim of cross-petitioner, Merlin R. Granger, is for the sum of $652.00. The said cross-petitioner is the owner of a Series D contract of the debtor, No. 35-5S-5292, registered August 1, 1939, and the cash surrender liability

claim of said cross-petitioner is stipulated by said contract to be $652.00 or more.

(15) The claim of cross-petitioner, Parke G. Smith, is for the sum of $375.00. The said cross-petitioner is the owner of a Series D contract of the debtor, No. 34S-17074, registered in the year 1938, (May 21st) and the cash surrender liability claim of said cross-petitioner is stipulated by said contract to be $375.00 or more.

(16) The claim of cross-petitioners, Bela Klein and/or Corrine Klein, is for the sum of $51.65. The said cross-petitioners are the owners of a Series D contract of the debtor, No. 35-5R-7240, registered November, 1938, and the cash surrender liability claim of said cross-petitioners is stipulated by said contract to be $51.65 or more.

(17) The claim of cross-petitioners, Harry J. Gilligan and/or Blanche J. Gilligan, Trustees for John J. Gilligan, Jeanne Gilligan, Frank J. Gilligan and Harry J. Gilligan, Jr. is for the sum of $880.00. The said cross-petitioners are the owners of a Series D contract of the debtor, No. 35-5U-779, registered October 8, 1938, and the cash surrender liability claim of said cross-petitioners is stipulated by said contract to be $880.00 or more.

## XII

On April 11, 1941, H. Isaiah Smith and Ross B. Thomas of Charleston, West Virginia, were appointed West Virginia, Kanawha Circuit Court, receivers for the greater portion [fol. 247] of the interest of said debtor in its securities and assets wherever situated. This was a proceeding in equity brought by Edgar B. Sims, Auditor of West Virginia and Ex-Officio Insurance Commissioner of West Virginia in the case entitled "Edgar B. Sims, Auditor of the State of West Virginia and Ex-Officio Insurance Commissioner of the State of West Virginia vs. Fidelity Assurance Association," No. 16724. Within two weeks thereafter, ancillary receivership proceedings in equity were brought and are pending against said debtor in fifteen states wherein debtor had made deposits of securities belonging to these cross-petitioning contract holders and all other contract holders of the debtor as parts of ten separate trust funds in which they have a beneficial interest.

Wherefore, your cross-petitioners pray:

a) That an order be entered herein permitting the filing of this cross-petition as a matter of absolute right;

b) That an order be entered herein permitting the filing of this cross-petition without further and additional deposit of costs, as an exception to the provisions of Section 132 of Chapter X of said Act; one deposit having been made;

c) That service of this cross-petition with a subpœna for the debtor may be made upon said debtor as provided in the Act of Congress relating to bankruptcy;

d) That an order be entered herein approving this cross-petition;

e) That the Trustee hereinbefore appointed in this proceeding be continued as Trustee with powers as provided by Chapter X of said Act;

[fol. 248] f) That a date be set by the Court not less than thirty days nor more than sixty days from the date of filing of this cross-petition for a hearing thereon as provided by Section 161 of Chapter X of said Act;

g) That the Court determine that the West Virginia laws established a basic and fundamental trust for the benefit of contract holders everywhere and that the laws of other states where the debtor also deposited securities, and filed in West Virginia in lieu of securities a certificate of such other state deposit, established a trust or a lien superimposed upon the basic West Virginia trust for the benefit of resident contract holder creditors of those other states.

h) That the Court determine that the course of conduct and operations of the debtor from the very first contact with the contract holder creditor established a trust relationship.

i) That the Court classify contract holder creditors:

1) Upon the basis of ten separate trust funds, to-wit: Special Income, Special Annuity, Special Annuity Matured and Retired, Series A, Series A Matured and Retired, Series B, Series B Matured and Retired, Series C, Series D, and Series D Matured and Retired.

2) And then further classify each of the above ten into those fully secured, those partially secured and those unsecured by the deposits of debtor within the states in which they reside.

j) That the Court order the duly qualified and acting Trustee in Reorganization not to change the total value of [fol. 249] the securities deposited in states other than West Virginia but to substitute securities therein by placing in each state securities belonging to the several funds against which residents of such state have cash surrender liability claims sufficient in value to approximately equal the portion of each separate fund's cash surrender liability claims of residents in the state bears to the total cash surrender liability claims of residents in the state, providing, however, that the character of the substitute securities meets with the requirements of the particular states' laws, rules and regulations.

k) That the Court order the duly qualified and acting Trustee in Reorganization to provide a plan of reorganization which includes

1) The debtor first meeting the requirements of the deposit laws, rules and regulations of the states requiring deposits by deb-or on or before June 6, 1941, according to the method prayed for in the previous paragraph and Part J of this prayer, and

2) The debtor making additional deposits of the remainder of the available securities of each fund, in those states requiring deposits by debtor on or before June 6, 1941, and in every other state wherein contract holders of the debtor reside, by trust funds in the proportion in which each state's cash surrender liability claims of residents of each fund bears to the cash surrender liability claims of residents of every state of each fund, credit being made for previous deposits made according to the method of Part J and K-1 of this prayer.

[fol. 250] l) That this Court enjoin the various state officials in control of securities deposited by the debtor from converting the income, dividends, and interest from the said securities and order the duly qualified and acting Reorganization Trustee to collect said income, dividends, and interest and place the same in the ten separate trust funds

of which the said securities are a part until each separate trust fund is restored to 100% of the cash surrender value so that those trust funds which are practically solvent at present and those other funds which will thereby become solvent can be administered in the manner provided by the terms of the contracts of the debtor, excepting interest and reserve provisions.

m) That further proceedings may be had upon this cross-petition in accordance with the provisions of Chapter X of said Act and that your cross-petitioners have such other relief as is just and necessary.

1 (S) D. C. Rivers, Individually and for the Ohio, Indiana-Kentucky Creditors Committee.

2 (S) Pauline Rivers, Individually and for the Ohio, Indiana-Kentucky Creditors Committee.

3 (S) R. A. McDowell, Individually and for the Ohio, Indiana-Kentucky Creditors Committee.

4 (S) Arthur C. Burroway, Individually and for the Ohio, Indiana-Kentucky Creditors Committee.

5 (S) W. Frank Armstrong, Individually and for the Ohio, Indiana-Kentucky Creditors Committee.

6 (S) Edward F. Wiederhold, Jr., Individually and for the Ohio, Indiana-Kentucky Creditors Committee.

7 (S) Carl H. Krippendorf, Individually and for the Ohio, Indiana-Kentucky Creditors Committee.

8 (S) William G. Werner, Trustee for Margaret Ann Werner and Wm. Thomas Werner, Individually as Trustee [fols. 251-256] and for the Ohio, Indiana-Kentucky Creditors Committee.

9 (S) James E. Traquair, Individually and for the Ohio, Indiana-Kentucky Creditors Committee.

10 (S) Merlin R. Granger, Individually and for the Ohio, Indiana-Kentucky Creditors Committee.

11. (S) John J. Rivers, Individually and for the Ohio, Indiana-Kentucky Creditors Committee.

12 (S) Parke G. Smith, Individually and for the Ohio, Indiana-Kentucky Creditors Committee.

13 (S) Bela Klein, Individually and for the Ohio, Indiana-Kentucky Creditors Committee.

14 (S) Harry J. Gilligan, Trustee for John J. Gilligan, Jeanne Gilligan, Frank J. Gilligan, and Harry J. Gilligan, Jr., Individually as Trustee and for the Ohio, Indiana-Kentucky Creditors Committee.

15 The Ohio Indiana-Kentucky Creditors Committee Of Fidelity Assurance Association, Cincinnati, Ohio. By (S) Harry J. Gilligan, Chairman Pro-tem.

(S) Raymond Huwe, Attorney for Cross-Petitioners 1016 First National Bank Bldg., Cincinnati, Ohio.

(S) John J. Rivers, Attorney for Cross-Petitioners, 711 Traction Building; Cincinnati, Ohio.

*Duly sworn to by D. C. Rivers, et al. Jurats omitted in printing.*

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[fol. 257] IN UNITED STATES DISTRICT COURT

[Title omitted]

ORDER OVERRULING PART OF MOTION OF D. C. RIVERS, ET AL., TO INTERVENE BY CROSS PETITION, GRANTING PART OF MOTION TO RECEIVE NOTICES, FILE PLEADINGS AND MOTIONS, PRESENT TESTIMONY AND ARGUMENTS AND PROCEED AS DEEMED NECESSARY AS AN OHIO-KENTUCKY-INDIANA CREDITORS COMMITTEE—September 15, 1941

At Lewisburg, West Virginia, in said district, on the 4th day of September, 1941, D. C. Rivers, Pauline Rivers, R. A. McDowell, Arthur C. Burroway, W. Frank Armstrong, William G. Werner, James R. Traquair, Bela Klein and Harry J. Gilligan, Trustee for John J. Gilligan, Jeanne Gilligan, Frank J. Gilligan and Harry J. Gilligan, Jr., Cincinnati, Hamilton County, Ohio, Edward F. Wiederhold, Jr., Lebanon, Warren County, Ohio, Carl H. Krippendorf, Perintown, Clermont County, Ohio, Parke G. Smith, Amberly Village, Hamilton County, Ohio, John J. Rivers, St. Bernard, Hamilton County, Ohio, and Merlin R. Granger, Cincinnati, Hamilton County, Ohio and Indianapolis, Marion County, Indiana, having previously, at Charleston, West Virginia in said district, on August 26, 1941, presented for filing their motion for leave to intervene by a cross-petition seeking reorganization of the debtor, as individuals and as an Ohio-Kentucky-Indiana Creditors Committee of which they are members and the Court being fully advised in the premises and it appearing that an order should be entered upon said motion to intervene and to be designated as a

committee to receive notices generally of all matters arising in these proceedings with the right to file motions, pleadings and other papers and to be heard by testimony [fol. 258-269] and by argument and to take such other steps and procedure as it might deem necessary;

It Is Ordered:

1. That the motion to intervene by cross petition of D. C. Rivers Et Al., be and the same is hereby overruled.

2. That the Ohio-Kentucky-Indiana Creditors' Committee of which D. C. Rivers, Et Al. are members and those others subsequent joining said creditors' committee, be known and designated as "The Ohio-Kentucky-Indiana Creditors Committee" hereinafter in this proceeding and it is hereby designated to receive notices generally of all matters arising in these proceedings and is authorized to file motions and pleadings and other papers and be heard by testimony and by argument and to take such other steps and procedure as it may deem necessary, subject to the provisions of Chapters X of the Act of Bankruptcy and the rules and orders of this court.

3. That the Ohio-Kentucky-Indiana Creditors Committee be notified of all matters and proceedings herein by sending notices to Raymond Huwe, one of its counsel, addressed to 1016 First National Bank Building, Cincinnati, Ohio.

Ben Moore, United States District Judge for the Southern District of West Virginia.

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[fol. 270] In United States District Court

[Title omitted]

Motion of A. Clyde Ross, Trustee, and Benjamin M. Ross to File Amended Answer—Filed September 17, 1941

To the Honorable Ben Moore, Judge of the District Court of the United States for the Southern District of West Virginia:

Now come A. Clyde Ross, Trustee, etc. and Benjamin M. Ross, and move the Court for leave under Rule 15(a) to

amend their answer by filing the proposed amended answer in this proceeding, a copy of which is hereto attached.

Raymond Huwe, 1016 First National Bank Bldg., Cincinnati, Ohio. John J. Rivers, 711 Traction Building, Cincinnati, Ohio, Attorneys for a Clyde Ross and Benjamin M. Ross.

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[fol. 271] IN UNITED STATES DISTRICT COURT

[Title omitted]

AMENDED ANSWER OF OHIO AND KENTUCKY CREDITORS ON BEHALF OF THEMSELVES AND ALL OTHER SIMILARLY SITUATED CREDITORS OF THE SAME AND EVERY OTHER STATE, CONTROVERTING THE ALLEGATIONS OF DEBTOR'S PETITION—Filed September 17, 1941

To the Honorable Ben Moore, Judge of the District Court of the United States for the Southern District of West Virginia:

Now come A. Clyde Ross, Trustee for Dorothy Eillen Ross, and A. Clyde Ross, Trustee for Shirley Jean Ross, of Cincinnati, Hamilton County, Ohio, and Jenjamin M. Ross of Fort Wright, Kenton County, Kentucky, on behalf of themselves and all other persons similarily situated, contract holders and creditors of the Fidelity Assurance Association, formerly The Fidelity Investment Association, who may come in and seek relief herein and say:

That the questions which are the subject of this action are of common and general interest to all contract holders of the debtor, irrespective of what states they are residents, and of what deposits are held in the respective states in which they reside;

That these defendants are informed and believe that all of the contract holders and creditors of the debtor are persons constituting a class so numerous as to make it impracticable to bring them all before this Court, and that these defendants, one as a resident of Ohio and the other as a [fol. 272] resident of Kentucky, will fairly insure the adequate representation of all similarly situated persons because the character of the right sought to be enforced for or against this class is

1) Several, and the object of the action is adjudication of claims which may affect specific property involved in this action, and upon which all of these persons have a claim as cestui qui trust beneficiaries and a lien; and

2) Several, and there are common questions of law and fact affecting the several rights, and a common relief is sought under Rule 23 of the New Federal Rules of Civil Procedure.

These defendants further state that no other answer of creditors, including that of Driehorst, et al., filed in this proceeding, nor any pleading on behalf of creditors of the debtor, protects the above mentioned cestui qui trust beneficiary rights and lien right of all of the creditors of the debtor, nor has any pleading of any particular state official on behalf of creditors of his state protected the basic and fundamental West Virginia cestui qui trust beneficiary rights and lien rights of all of the creditors of the debtor, nor have the pleadings filed herein by Edgar B. Sims, Auditor of West Virginia and ExOfficio Insurance Commissioner of West Virginia, or the pleadings of the receivers of the debtor, Ross B. Thomas and H. Isaiah Smith, protected the basic and fundamental West Virginia cestui qui trust beneficiary rights and the lien rights of all contract holders of the debtor.

These defendants further state

1) That a statute of the United States, to-wit: Sections 137, 206 and 209 of Chapter X of the Bankruptcy Act (Chandler Act) as amended August 22, 1940, confers upon them an unconditional right to intervene in this proceedings;

[fol. 273] 2) That the representation by existing parties to this proceeding of their interests and the interests of all others similarly situated is inadequate, or may be inadequate, and their interests and the interests of all others similarly situated is, or may be, bound by a judgment in this action; and

3) That these defendants and all others similarly situated may be adversely affected by a distribution or other disposition of the property in the custody of the Court or in the custody of the Trustee, in reorganization or in liquidation, as an official of this Court.

These defendants state that the above circumstances provide them with the power to intervene in this proceeding as a matter of right, pursuant to rule 24(a) of the New Federal Rules of Civil Procedure.

In the alternative these defendants state that if the statutes of the United States, Sections 137, 206 and 209 of Chapter X of the Bankruptcy Act (Chandler Act) as amended August 22, 1940, do not confer an unconditional right to intervene, they confer a conditional right to intervene under the conditions described as appertaining to rule 23 hereinbefore stated, and further state that their claim and defense have questions of law and fact in common with the main action in this proceeding, and state that their intervention will not unduly delay or prejudice the adjudication of the rights of the original parties herein, as required in rule 24(b).

For an amended answer to the allegations of the petition of the debtor heretofore filed upon the 6th day of June, 1941, these answering defendants, after examining the records and reports of the debtor and of the former West Virginia state court receivers and of the Reorganization Trustee now serving in this proceeding, further aver:

[fol. 274] I

For an amended answer to Part I of said petition, these answering defendants admit the corporate existence of debtor under the laws of West Virginia until March 31, 1941, and its existence as a defacto corporation of West Virginia thereafter, including June 6, 1941, which could be reorganized under the provisions of Chapter X of the Bankruptcy Act of 1938 as amended August 22, 1940.

These answering defendants aver that the interests of the debtor in securities deposited by it with the West Virginia State Treasurer and/or the West Virginia Auditor and Ex-Officio Insurance Commissioner at Charleston, West Virginia, are of an equitable nature and are and were located in said city, and the Southern District of West Virginia for a longer portion of the six months immediately preceding the filing of the petition than in any other district by reason of the fact that the legal title holder of said securities and the trustee of said securities for the primary benefit of all cestui que trust contract holders, wherever residing, and for the secondary and resulting trust benefit

of the debtor, is personally within said city and district, and that said legal title-holder and trustee placed said securities, 95% endorsed to bearer, in the vaults of the Kanawha Valley Bank located in Charleston, West Virginia in said judicial district.

These answering defendants further aver that under the provisions of Section 3443(3) of Michie's Code of West Virginia laws the Treasurer of West Virginia and/or Auditor and Ex-Officio Insurance Commissioner of West Virginia is or are trustee or trustees of said securities, 95% of which are endorsed to bearer, for the benefit of all contract holders of the Special Income, Special Annuity, Special Annuity Matured and Retired, Series A, Series A Matured and Retired, Series B, Series B Matured and Retired, Series C, Series D, and Series D Matured and Retired funds of the debtor and that debtor's resulting and secondary equity [fol. 275] trust interests in said assets have existed within the above named judicial district and that said interests are its principal assets.

These answering defendants further aver that the majority of the above described trust funds are solvent and the debtor has a resulting trust equitable interest in the securities deposited in said district belonging to said solvent trust funds and that the debtor also has a resulting trust equitable interest in the securities deposited in said district belonging to the insolvent trust funds of debtor, and that the resulting trust equitable interest of the debtor in the securities belonging to solvent and insolvent trust funds is the only kind of interest which debtor owns in any of its assets, real or personal, and that all of its interests in any of its assets is junior to securities issued by it and deposited by it in said city and district in trust for the benefit of contract holders and these answerng defendants.

II

For an amended answer to Part II of said petition these answering defendants admit that the debtor is a corporation which could be adjudged a bankrupt under the Bankruptcy Act.

These answering defendants further aver that the debtor did not operate as an insurance company, that its 1941 West Virginia three months temporary license to do business as an insurance company expired; that it failed to secure a license to do business in any other state as an insurance com-

pany and that the nature of its business during and after its temporary license to do business as an insurance company was that of a bond investment company, receiving and disbursing installment payments upon previously sold installment face amount certificates, installment annuities and installment saving contracts.

These answering defendants further aver that the debtor until and including December 31, 1940 was a de jure install- [fol. 276] ment bond and face certificate investment corporation, and since January 1, 1941 when it failed to qualify under the National Investment Company Act of 1940, has been a de facto installment bond and face certificate investment corporation and could be adjudged a bankrupt under the said Act.

These answering defendants admit that the debtor is not a municipal, insurance or banking corporation nor a building and loan association nor a railroad corporation.

III

For an amended answer to the first paragraph of Part III of said petition these answering defendants admit all of the allegations thereof.

For an amended answer to the second paragraph of Part III of said petition these answering defendants admit all of the allegations thereof.

These answering defendants further aver that the business executed by the debtor during its three months temporary West Virginia license as an insurance company and since the expiration of that license has been that of a de facto installment bond and face certificate investment corporation.

IV

For an amended answer to Part IV of said petition these answering defendants admit all of the allegations thereof.

V

For an amended answer to Part V of said petition these answering defendants admit that the debtor has in existence and outstanding investment and annuity contracts of a total reserve liability of approximately $26,685,999.79.

These answering creditors further aver that the debtor has a resulting trust equitable interest, junior to the cestui que trust beneficiary interest of contract holders of the

debtor, in securities of the West Virginia sound-appraisal [fol. 277] value of approximately $23,000,000 of which approximately $13,000,000 sound-appraisal value are situate in Charleston, West Virginia in the Southern District of West Virginia.

These answering defendants, for want of information and belief, neither affirm nor deny the correctness and veracity of the fullness or truthfulness of the statement of all of the assets and liabilities of debtor, incorporated by reference in Part V of the debtor's petition, and attached to said petition and marked "Exhibit A" therein, but aver that said "Exhibit A" is the only financial statement in existence which shows the financial condition of the debtor as of October 31, 1940 and should be accepted as such by the Court with reservations as to its correctness and veracity.

VI

For an amended answer to Part VI of said petition these answering defendants admit all of the allegations thereof with reference to the West Virginia, Kanawha County Circuit Court Receivership suit and receivership suits in other states.

These answering defendants further aver that the debtor's resulting trust equitable interest in the securities deposited by debtor in states other than West Virginia in the approximate West Virginia sound-appraisal value of $10,000,000 is or are the asset or assets of the debtor which these other state receivers, at least fifteen in number, have taken charge of for the benefit of resident contract-holders of their state.

These answering defendants further aver that contract-holder-creditors of the debtor, residing in almost every other state, have a primary equitable and cestui que trust interest in the securities deposited in every state where these state receivers have taken charge for the benefit of the resident contract holders of their state.

VII

For an amended answer to Part VII of said petition these [fol. 278] answering defendants admit all of the allegations thereof concerning the necessity to modify the contracts of the debtor and its contract holders with reference to interest and reserve provisions and concerning the inadequacy

of relief under Chapter XI of the Act with reference to such modifications.

These answering defendants further aver, with reference to the third paragraph of Part VII of said petition, that each of the contracts of the debtor, according to the terms of said contracts, is secured by a reserve fund.

These defendant-creditors further state that debtor's course of conduct and operations has been such as to establish not only a reserve fund but an actual trust with title divested from itself and in the Auditor and Ex-Officio Insurance Commissioner of West Virginia or the Treasurer of West Virginia, of securities purchased from the payments of these defendant-creditor contract holders, and all others similarly situated, and that deposits of securities made in states other than West Virginia are a part of said trust, legal title to which is in the Auditor and Ex-Officio Insurance Commissioner or Treasurer of West Virginia, but which have been deposited in other states in lieu of being deposited in the custody of the officials of West Virginia.

These answering defendants further aver that those deposits of securities in states other than West Virginia are either held as a trust imposed upon the basic and fundamental trust in West Virginia, or as a bailment or pledge imposed upon the basic or fundamental trust in West Virginia, and are a trust upon a trust, or a bailment upon a trust, according to the functions of the officials of said other states, as established by the laws of said states.

These answering defendants further aver that the solvency of the majority of trust funds described by the debtor as reserve funds, prevents a forfeiture of the equity of [fol. 279] redemption or resulting trust equitable interest of the debtor in the securities belonging to said trust and reserve funds.

VIII

For an amended answer to Part VIII of said petition these answering defendants admit all of the allegations thereof.

IX

For an amended answer to Part IX of said petition, these answering defendants, after examining the records and reports of the debtor and of the former West Virginia State Court Receivers and of the Reorganization Trustee now

serving in this proceeding, join in the desire of the debtor that a plan of reorganization be affected under the provisions of Chapter X of the Bankruptcy Act.

The Investors Syndicate, a Minnesota corporation, and a competitor of the debtor, has qualified under the provisions of the Investment Company Act of 1940 and the wholly owned subsidiary of the debtor, Fidel Association of New York, Incorporated, has always met in the stringent requirements of the laws of New York and Connecticut and the regulatory control of their state officials, and these answering defendant creditors believe that a plan of reorganization is reasonable which may be similar to the organization of any competitor now qualifying and operating under provisions of the Investment Company Act of 1940.

These answering defendants further aver that if new capital is required it might be obtainable from the Reconstruction Finance Corporation or from other public or private sources, or from income of the separate trust funds of debtor according to the plan expressed in Part F of the prayer of this amended answer.

These answering defendants further aver that the specific facts showing the need for relief under Section X of said Act are as follows:

[fol. 280] 1. The earnings from Investments of said debtor required by the laws and rules and regulations of officials of various states in recent years have been insufficient, and the prospective earnings in future years at present appear to be insufficient to enable it to meet its liabilities under its contracts executed with its contract holders;

2. The assets in which the debtor has an interest, to-wit: industrial, financial, railroad, public utility, federal farm loan, municipal, U. S. Government, foreign governmental, foreign corporation, and real estate bonds and mortgage notes and domestic corporation preferred stocks, are of substantial value and will mature in the future at a higher value than their present market values, which on June 6, 1941 approximated $23,640,000. These assets, if preserved and not liquidated or sold at this time, will have a much greater value as assets of a reorganized going concern and will provide the contract holding creditors of the debtor, if the debtor is reorganized, with a much greater return to them of their investment and money than if

presently liquidated and if hereafter valued upon the current standards established by the National Association of Insurance Commissioners or by the Board of Governors of the Federal Reserve Banking System;

3. The debtor has not qualified to do business under the Investment Company Act of 1940;

4. The debtor is in need of reorganization for the above reasons and cannot successfully effect a reorganization unless under a judicial proceeding in a court with nationwide jurisdiction.

5. The proposed reorganization by the West Virginia Auditor and Ex-Officio Insurance Commissioner under the West Virginia, Kanawha Circuit Court, became ineffective when that Court's jurisdiction did not include jurisdiction [fol. 281] over the officials in fifteen different states holding deposits of the debtor and who could not be enjoined from selling securities deposited by the debtor in which the contract holders had an interest. The only judicial proceeding in which the debtor can be effectively reorganized, in view of the above facts, is the Federal Court with nationwide jurisdiction to prevent any acts prejudicial to the interest of the contract holders in the debtor's deposits in West Virginia and in all other states.

X

For an amended answer to Part X of said petition these answering defendants admit, as true and correct, the statements in the resolution of the debtor, "Exhibit B" of debtor's petition.

These answering defendants further aver that the insolvency of some of the trust funds of the debtor provide the debtor with a resulting trust interest in securities deposited by it in Charleston in the Southern District of West Virginia and provide the United States District Court in that district with jurisdiction and venue over the debtor's property, the legal title holder and trustee personally residing and having official office headquarters therein and the securities, 95% endorsed to bearer, physically deposited, therein in the control of the legal title holder and trustee.

These answering defendants further aver that those members of the Board of Directors who may not have ob-

tained exemptions from the application of the rules and regulations of the Securities and Exchange Commission and the provisions of the Investment Company Act of 1940, and who may not have complied with the provisions of the injunction of December, 1939, and including that member of the Board of Directors who had not qualified as a stockholder and who was elected for and served only for that part of the meeting in which the resolution to file a petition under Chapter X of the Bankruptcy Act was voted upon, were de facto directors of the debtor upon [fol. 282] June 3, 1941, and their action in passing the resolution heretofore described upon said date is binding upon the corporation and all third persons upon collateral attack, including the creditors-contract-holders of the debtor, the state officials of the various states in which the debtor was engaged in business, and the state and federal court receivers appointed for the debtor therein.

These answering defendants further aver that the debtor was a de facto installment bond investment and face amount certificate corporation, and that the action of its Board of Directors in passing the resolution authorizing the filing of a petition for reorganization under Chapter X of said Act is valid and sufficient to obtain the relief sought under Chapter X of said Act.

These answering defendants further aver that the insolvency of the debtor with respect to some of the trust funds and the failure of its total assets to equal its total liabilities upon June 3, 1941 changed the directors of the debtor to trustees for creditors only with claims prior to those of the corporation and stockholders in the resulting trust interest of the debtor in its securities-assets and the meeting and resolution of that date was not required to meet the provisions of by-laws; protecting the corporation, officers, directors and stockholders with respect to the contents of the notice and place of meeting; to be an effective attempt to obtain relief by petition for reorganization under Chapter X of the Act.

Wherefore, your answering defendants pray:

A) That the Court determine that the West Virginia laws established a basic and fundamental trust for the benefit of the contract holders everywhere and that the laws of other states where the debtor also deposited securities, and filed in West Virginia in lieu of securities a certificate

of such other state deposit, established a trust or a lien [fol. 283] superimposed upon the basic West Virginia trust for the benefit of resident contract holder creditors of those other states.

B) That the Court determine that the course of conduct and operations of the debtor from the very first contact with the contract holder creditor established a trust relationship and that the installment cash payments of the contract holder, while for a short time commingled with cash payments of different trust funds into a single cash bank account were always separately maintained upon the debtor's books as separate trust fund cash accounts and subsequently invested in securities held separately as trust funds.

C) That the Court classify contract holder creditors:

1) Upon the basis of ten separate trust funds, to-wit: As Special Income, Special Annuity, Special Annuity Matured and Retired, Series A, Series A Matured and Retired, Series B, Series B Matured and Retired, Series C, Series D, and Series D Matured and Retired.

2) And then further classify each of the above ten into those fully secured, those partially secured and those unsecured by the deposits of debtor within the states in which they reside.

D) That the Court order the duly qualified and acting Trustee in Reorganization not to change the total value of the securities deposited in states other than West Virginia but to substitute securities therein by placing in each state securities belonging to the several funds against which residents of such state have cash surrender liability claims sufficient in value to approximately equal the proportion which each separate fund's cash surrender liability claims of residents in the state bears to the total cash surrender liability claims of residents in the state, providing, however, [fol. 284] that the character of the substitute securities meets with the requirements of the particular states' laws, rules and regulations.

E) That the Court order the duly qualified and acting Trustee in Reorganization to provide a plan of reorganization which includes

1) The debtor first meeting the requirements of the deposit laws, rules and regulations of the states requiring

deposits by debtor on or before June 6, 1941, according to the method prayed for in the previous paragraph and Part D of this prayer, and

2) The debtor making additional deposits of the remainder of the available securities of each fund, in those states requiring deposits by debtor on or before June 6, 1941, and in every other state wherein contract holders of the debtor reside, by trust funds in the proportion in which each state's cash surrender liability claims of residents of each fund bears to the cash surrender liability claims of residents of every state of each fund, credit being made for previous deposits made according to the method of Part- D and E-1 of this prayer.

F) That this Court enjoin the various state officials in control of securities deposited by the debtor from converting the income, dividends, and interest from the said securities and order the duly qualified and acting Reorganization Trustee to collect said income, dividends, and interest and place the same in the ten separate trust funds of which the said securities are a part until each separate trust fund is restored to 100% of the cash surrender value so that those trust funds which are solvent at present and those other funds which will thereby become solvent can be admin-
[fol. 285] istered in the manner provided by the terms of the contracts of the debtor, excepting interest and reserve provisions.

G) That further proceedings may be had upon this amended answer in accordance with the provisions of Chapter X of said Act and that your answering defendants have such other relief as is just and necessary.

A. Clyde Ross, Trustee for Dorothy Eillen Ross and A. Clyde Ross, Trustee for Shirley Jean Ross, 6316 Iris Avenue, Cincinnati, Ohio. Benjamin M. Ross, 18 Crittenden Ave., Fort Wright, Kenton County, Kentucky.

*Duly sworn to by A. Clyde Ross et al. Jurat omitted in printing.*

[fols. 286-286a] IN UNITED STATES DISTRICT COURT

[Title omitted]

ORDER OVERRULING MOTION OF A. CLYDE ROSS, TRUSTEE, AND BENJAMIN M. ROSS SEEKING TO AMEND THEIR ANSWER BY FILING AN AMENDED ANSWER—September 17, 1941

At Charleston, West Virginia, in said District, on the 16th day of September, 1941, A. Clyde Ross, Trustee and Benjamin M. Ross, having been granted leave upon July 19, 1941 to file an answer controverting the debtor's petition in this proceeding, on behalf of themselves and/or their beneficiaries and all others similarly situated, now move to amend their answer during the progress of the hearing upon the jurisdiction of the Court in this proceeding, by filing an amended answer in which they now join with the debtor in its desire to be reorganized.

And the Court, finding that the proposed amended answer of said creditors does not controvert the debtor's petition, as contemplated by the provisions of Section 137 of Chapter X of the Bankruptcy Act,

It Is Ordered that the motion of A. Clyde Ross, Trustee, and Benjamin M. Ross to amend their answer by filing said amended answer is hereby overruled and denied, to all of which A. Clyde Ross, Trustee, and Benjamin M. Ross, except.

Ben Moore, Judge of the District Court of the United States.

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[fols. 287-288] IN UNITED STATES DISTRICT COURT

[Title omitted]

ORDER APPROVING ELECTION, ETC.—October 2, 1941

This day came the Debtor, by its attorneys, and represented to the Court that a meeting of its Stockholders and a meeting of its Directors are scheduled to be held at Wheeling, West Virginia, on October 3, 1941, and moved that the Court approve the election at said Stockholders meeting of Philip D. Paull, James Paull, Robert Riley, Elwood Thomas, T. Harvey Pollock, H. Julian Ulrich, W. L. Burt, A. C. Hazlett, Gordon Hobstetter and George Miller

as Directors to fill vacancies, and the election at said Directors meeting of Allen G. Messick as Chairman of the Board, John Marshall, Sr. as President, F. H. Pulfer as Vice-President and Secretary, John Marshall, Jr., as Vice-President and Treasurer, Howard E. Reed as Vice-President, W. J. Gribben as Auditor, H. C. Hobstetter as Registrar, C. E. Smith as Assistant Secretary, M. von Berg as Assistant Treasurer, M. A. Monahan as Assistant Registrar, and Allen G. Messick, John Marshall, Sr. John Marshall, Jr., F. H. Pulfer and D. A. Burt as members of the Executive Committee, and upon consideration whereof the Court doth sustain the said motion, and it is Ordered that the election of the above named persons as directors, officers and members of the Executive Committee of the Debtor, respectively, is hereby approved.

Ben Moore, Judge U. S. D. C.

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[fol. 289] IN UNITED STATES DISTRICT COURT

[Title omitted]

PETITION OF TRUSTEE SEEKING INSTRUCTIONS OF THE COURT ON AN OFFER RECEIVED BY THE TRUSTEE FOR THE PURCHASE OF FIDEL ASSOCIATION OF NEW YORK—Filed October 3, 1941

To the Honorable Ben Moore, Judge of Said Court:

Your petition respectfully represents unto the Court that on the 25th day of September, 1941, it received a letter from Pell, Ltd., of 80 Broad Street, New York City, and a purported list of the directors of Pell, Ltd., wherein the said Pell, Ltd. offer to purchase from your Trustee for cash all of the common stock of Fidel Association of New York, Incorporated, at the liquidating value thereof to be determined by Haskins & Sells as of the date of delivery of such stock.

All of the said common stock of Fidel is owned by the debtor herein and is on deposit with the Insurance Commissioner of West Virginia, along with other securities held by said Commissioner. Attached hereto and incorporated in this petition by reference is a copy of the letter and list of directors received from Pell, Lt-., as aforesaid. Your petitioner has caused notice to be given to the parties to this suit that this petition would be presented on the third

day of October, 1941, at ten o'clock A. M., and your petitioner has requested the said Pell, Ltd., to have its attorney or other representative present in court on said day to give such further explanations to the aforesaid offer as the Court or any party in interest may deem proper.

Your petitioner therefore prays that this petition be filed, that a hearing be held hereon on the said third day of October, 1941, and that such order be entered in connection herewith as may appear proper to the Court.

Central Trust Company, Trustee, by A. A. Payne, Vice President.

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[fol. 290] EXHIBIT TO PETITION

Copy

Chemical, Pharmaceutical and Industrial Development Management and Organization.

Pell, Ltd.

New York

80 Broad Street

September 24, 1941.

Central Trust Company, Trustee in Reorganization of Fidelity Assurance Association, Charleston, West Virginia.

DEAR SIRS:

We hereby offer to purchase from you for cash all of the common stock of Fidel Association of New York, Incorporated at the liquidating value thereof to be determined by Haskins & Sells as of the date of delivery of such stock.

This offer is predicated upon the accuracy of a balance sheet of Fidel Association of New York, Incorporated as of June 30, 1941 and a statement relating to its income and expenses for the six months ending that date, which were submitted for our examination by Mr. Hubert F. Young on September 19, 1941.

It is a term of this offer that, when establishing liquidating value, Haskins & Sells are to appraise underlying securities at market value and not at cost.

This offer may be accepted by you, with the approval of the United States District Court for the Southern District

of West Virginia at any time within thirty days from September 19, 1941.

When, as and if this offer is accepted, we are prepared to give serious consideration to furnishing additional capital in Fidelity Association of New York, Incorporated for the purpose of reorganizing Fidelity Assurance Association,, if some equitable plan, satisfactory to us, can be agreed upon by the necessary parties in interest.

Yours very truly, Pell, Ltd., by Arlen G. Swiger, Secretary and Treasurer.

[fol. 291] Pell, Ltd.
Directors

| | |
|---|---|
| ARMOUR, B. R. 50 Union Square, New York, N. Y. | |
| American Aniline Products, Inc | Pres., Treas. and Dir. |
| Ansbacher-Siegle Corp | Pres. and Dir. |
| The Aspinook Corporation | Director |
| Charles Helmuth Prtg. Ink Corp | President |
| The Hartford Rayon Corporation | Pres. and Director |
| Heyden Chemical Corp | Pres. and Director |
| CALDER, CURTIS E. 2 Rector Street, New York, N. Y. | |
| American & Foreign Power Co. Inc | Pres. and Dir. |
| A. T. Walraven Book Cover Co | V. Pres. and Dir. |
| British Columbia Power Corp. Ltd | Director |
| Italian Superpower Corp | Director |
| National City Bank of N. Y | Director |
| Selected Industries Inc | Director |
| Southwestern Sewer Co | Pres. and Dir. |
| U. S. & Foreign Securities Corp | Director |
| U. S. & International Securities Corp | Director |
| DIFFENBACH, B. G. 117 Liberty St., New York, N. Y. | |
| Blair & Co. Inc | Vice-Pres. and Dir. |
| Blair Securities Corp | Director |
| Cuban American Manganese Corp | Director |
| Electric Ferries, Inc | Pres. and Dir. |
| Freeport Sulphur Co | Director |
| Brooklyn and Richmond Ferry Co | Director |
| Bayonne-Staten Island Ferries, Inc | Director |
| EMANUEL, VICTOR 420 Lexington Avenue, New York, N. Y. | |
| Albert Emanuel Co. Inc | Pres. and Dir. |
| Aviation & Transportation Corp | Pres. & Chrmn. of Bd. |
| The Aviation Corp | Pres. and Director |
| Emanuel & Co | Limited Partner |
| Pak-Age-Car Corp | Director |
| Republic Steel Corp | Member Ex. Com. & Dir. |
| Standard Gas & Electric Co | Chairman of Board |
| Standard Power & Light Corp | Pres. & Director |
| GUMPERT, L. JAMES 386 Fourth Avenue New York, N. Y. | |
| B. T. Babbitt & Co | Director of Sales |
| Holly Products Corp., Calif | Secretary |
| B. Meyers Lye Corp., St. Louis | Secretary |

JOSEPOWITZ, GRIGORI 224 W. 30th St., New York, N. Y.

| | |
|---|---|
| Societe Industrielle pour le traitment des Metaux, Paris, France | Pres. and Director |
| Societe Parisienne des Products Chemiques, Paris, France | Pres. and Director |
| Eitingon-Josef, Inc. New York | Pres. and Director |

[fol. 292]

KRAMER, RAYMOND C. 253 Broadway New York, N. Y.

| | |
|---|---|
| Allied Stores Corp. | Director |
| Belcort Corp | Pres. and Dir. |
| Continental Shares | Director |
| Gimbel Bros. Inc. | Director |
| Interstate Dept. Stores, Inc | Chrmn. of Board |
| Postal Telegraph Cable Co | Director |
| Selby Shoe Co., Portsmouth, O | Director |
| Stowell Spool Co., Portland, Me | Director |
| Transcontinental & Western Air, Inc | Director |
| United Cigar-Whelan Stores Corp | Director |

PELL, HAMILTON 40 Wall Street, New York, N. Y.

| | |
|---|---|
| Pell & Co. (Members N. Y. Stock Ex.) | Senior Partner |
| Aeony Corp. | V. Pres. and Dir. |
| The Aspinook Corporation | Director |
| Chemicals & Pharmaceuticals, Inc. | Pres. and Dir. |
| Community Power & Light Co | Director |
| Compo Shoe Machinery Corp. | V. P., Member Ex. Com. and Director |
| Consolidated Corp | V. Pres. and Dir. |
| Directory of Directors | Director |
| Dominion Gas & Electric Co | Director |
| Electric Ferries, Inc | Director |
| General Public Utilities, Inc | Director |
| General Water, Gas & Electric Co. | Director |
| The Hartford Rayon Corporation | Director |
| Houston Gulf Gas Co. | Director |
| International Utilities Corp | Director |
| Mengel Co | Director |
| Professional Laboratories, Inc | Director |
| Standard Gas & Electric Co | Director |
| U. S. Vitamin Corporation | Mem. Ex. Com., Chrmn. of Board |

RICHARD, HAROLD C. 681 Eighth Avenue, New York, N. Y.

| | |
|---|---|
| 1060 Fifth Avenue | Treas. and Dir. |
| Adolf Gobel, Inc | Director |
| Carib Syndicate, Limited | Director |
| Foundation Co. (Foreign) The | V. P. and Dir. |
| General Bronze Corp | Chrmn. of Board |
| Graniteville Co. | Director |
| Manufacturers Trust Co | Director |
| Midland Steel Products Co | Director |
| Murray Corp. of America | Director |
| Northeastern Insurance Co. of America | Director |
| U. S. Vitamin Corporation | Director |

SCHATZKIN, HENRY A. 80 Broad Street, New York, N. Y.

| | |
|---|---|
| Chemicals & Pharmaceuticals, Inc | Director |
| U. S. Vitamin Corporation | Director |

[fol. 293]

STARR, CORNELIUS V. 111 John St., New York, N. Y.

| | |
|---|---|
| American Asiatic Underwriters Federal, Inc., U. S. A. of Shanghai, China | Director |
| American International Underwriters Corp. of N. Y. | Director |
| Asia Life Insurance Co. Shanghai, China and Wilmington, Del. | Chrmn. of Board |
| Compagnie Franco Americaine d'Assurances of Paris, France | Director |
| International Assurance Co. Ltd. Shanghai, China | Director |
| Tai Shan Insurance Co. Ltd. Shanghai, China | Director |
| Underwriters Bank for the Far East, Inc. of Shanghai, China, and Conn. | Director |
| U. S. Life Insurance Co. in the City of New York (The) | Pres. and Dir. |

STEWART, CECIL P. 67 Wall Street, New York, N. Y.

| | |
|---|---|
| American Merchant Marine S. S. Corp. | Pres. and Dir. |
| Atlantic Coast Fisheries Co. | Director |
| Bloedel Donovan Lumber Mills | Director |
| C. P. Stewart & Co. Inc. | Pres. and Dir. |
| C. P. Stewart & Co. Ltd. (London, England) | Chrmn. of Board |
| Centre Island Association | President |
| Dawnic Steamship Corp. | Director |
| Frank B. Hall & Co. Inc. | Pres. and Chrmn. of Board |
| Hall Murphy & Co. of Oregon | Chrmn. of Board |
| Incorporated Village of Centre Island | Trustee |
| Lawyers Title Corp. of N. Y. | Director |
| Munson Line, Inc. | Chmn. of Board |
| Oregon Steamship Corp. | Pres. and Dir. |
| Pilot Reinsurance Co. of N. Y. | Director |
| Stewart, James & Co. | Chrmn. of Board |

SWIGER, ARLEN G. 60 East 42nd Street, New York, N. Y.

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| Swiger, King & Chambers | Senior Partner |
| The Aspinook Corporation | Secy. and Dir. |
| Compo Shoe Machinery Corp. | Director |
| The Hartford Rayon Corporation | Director |
| North European Oil Corp. | V. Pres. and Dir. |
| U. S. Vitamin Corporation | Secy., Dir., Mem. Exec. Committee |

WASEY, LOUIS R. 420 Lexington Ave., New York, N. Y.

| | |
|---|---|
| Erwin Wasey & Co. | Pres. and Dir. |
| Primrose House, Inc. | Director |

ROSENBLATT, WILLIAM 80 Broad St. New York, N. Y.

| | |
|---|---|
| Cuban Iron Ore Co. | Vice Pres. & Dir. |
| Modern Industrial Bank of N. Y. C. | Dir. |
| Postal Telegraph Inc. | " |
| U. S. Vitamin Corporation | " |

[fol. 294] IN UNITED STATES DISTRICT COURT

[Title omitted]

ORDER—October 4, 1941

Coming now for consideration the petition of Edward J. Hughes, Secretary of State of the State of Illinois, Warren Wright, Treasurer of the State of Illinois, by George F. Barrett, Attorney General of the State of Illinois, and S. Leigh Call, Receiver of Fidelity Association, by appointment of the Circuit Court of Sangamon County, Illinois, by Edmund Burke, and Gillespie, Burke & Gillespie, his attorneys; and the Court having considered the said motion;

It is hereby ordered with respect to the turn-over orders entered by this Court on the 6th day of June, the 10th day of June and the 9th day of August, 1941, and all orders heretofore entered herein in any way modifying or affecting the same are hereby interpreted and declared by the Court with respect to the securities in Illinois deposited by the Debtor for the benefit of contract holders, that the said State Treasurer and Secretary of State of the State of Illinois be not required by virtue of said orders to turn over physical possession of such securities to the Trustee of the Debtor herein until such time as a plan for reorganization has been regularly adopted and approved by this Court and approved by the creditors of the Debtor under the provisions of Chapter 10 of the United States Bankruptcy Act.

It is further ordered and declared that it shall not be a violation of the aforementioned order for S. Leigh Call, Receiver aforesaid, to return to and pay over to the proper state officials of the State of Illinois any and all such assets of the Debtor received by him from such officials under [fols. 295-298] the direction of the Circuit Court of Sangamon County, Illinois.

Whereupon, the said Warren Wright, Treasurer of the State of Illinois, Edward J. Hughes, Secretary of the State of Illinois, and S. Leigh Call, Receiver as aforesaid, withdraw their several answers, petitions and motions heretofore filed and now pending in these proceedings. Said interveners, however, reserve their respective status as an intervener in these proceedings, and their right to participate as such herein.

Entered this 4th day of October, 1941.

Ben Moore, United States District Judge.

[fols. 299-300] IN UNITED STATES DISTRICT COURT

[Title omitted]

ORDER FILING REPORT OF TRUSTEE—October 10, 1941

This day came the Central Trust Company, Trustee, and presented to the Court the first part of its report as required by Section 167 of the Federal Bankruptcy Act, which said first portion of said report is hereby ordered filed.

Ben Moore, U. S. D. J.

(The Report of the Trustee under Sec. 167, Chap. 10 of the Bankruptcy, referred to in the foregoing order, is omitted from the record at this point as same is being transmitted in original form in accordance with instructions of Court Order entered March 7, 1942).

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[fol. 301] IN UNITED STATES DISTRICT COURT

[Title omitted]

MOTION BY EDGAR B. SIMS, AUDITOR AND EX-OFFICIO INSURANCE COMMISSIONER OF THE STATE OF WEST VIRGINIA—Filed October 27, 1941

This 27th day of October, 1941, comes Edgar B. Sims, Auditor and Ex-Officio Insurance Commissioner of the State of West Virginia, and relates unto the Court that he has been permitted by the Court to intervene in this case, by reason of the fact that certain orders of the Court made on June 6th, June 10th and August 9th, 1941 were entered by the Court which affect him in his official capacity as an official of the State of West Virginia.

Your said petitioner hereby moves the Court that the injunctive order of August 9, 1941, in so far as it affects your petitioner, be dissolved, for the reason that the deposit of Fidelity Assurance Association was made to and with the State of West Virginia in pursuance of the statutes of West Virginia and in accordance therewith, and by virtue of the fact that the said company at the time the said deposit was made was a copy within the purview of Section 1, Article 9, Chapter 33 of the Code of West Virginia, and the said deposit was made by virtue of Section 3 of said Article 9.

Your petitioner further relates unto the Court that the license of said company, issued by virtue of said Section 1 of Article 9, was not renewed as of January 1, 1941, and on April 1, 1941, the license of the said company to sell insurance was revoked by your said petitioner, and thereafter no license was or is held by the said company to solicit or receive deposits or payments on any annuity contracts or certificates, or annuity bonds, within the State of West Virginia, nor any license to sell insurance policies within the State of West Virginia.

Your petitioner says that by virtue of Section 10 of said Article 9, when the said license of the debtor was not renewed on January 1, 1941, and its license was revoked on April 1, 1941, it became his duty, by virtue of said Section 10 of the laws of the State of West Virginia, to retain authority and control over the deposit of the debtor with the [fol. 302] State of West Virginia until the total liability for contract certificates or annuity bonds and contracts issued by the debtor in the State of West Virginia was redeemed or settled, and that the said injunctive order interferes with and prevents the performance of his official duties, by virtue of said Section 10, and his official discretion thereunder, and should therefore be dissolved.

Your petitioner further says that said statutes of the State of West Virginia were lawfully passed and are not an interference with the Court or superseded by the Bankruptcy Act, and that the issuance of the said injunctive order is in purpose and effect a suit or proceedings against an official representative of the Sovereign State of West Virginia, and is therefor prohibited by the Eleventh Amendment to the Constitution of the United States.

Therefore, your petitioner moves this Honorable Court that in so far as said injunction affects him in his official and representative capacity as an official of the State of West Virginia, and in so far as said injunction is a suit or proceedings against the Sovereign State of West Virginia, that the said injunction be dissolved.

Edgar B. Sims, Auditor and Ex-Officio Insurance Commissioner of the State of West Virginia, by Clarence W. Meadows, Attorney General, and Ira J. Partlow, Assistant Attorney General of the State of West Virginia, (S.) Clarence W. Meadows, Ira J. Partlow.

[fol. 303] IN UNITED STATES DISTRICT COURT

[Title omitted.]

MOTION BY EDGAR B. SIMS, AUDITOR AND EX-OFFICIO INSURANCE COMMISSIONER OF THE STATE OF WEST VIRGINIA, ON BEHALF OF ROSS B. THOMAS AND H. ISAIAH SMITH, WEST VIRGINIA STATE COURT RECEIVERS—Filed October 27, 1941

This 27th day of October, 1941, comes Edgar B. Sims, Auditor and Ex-Officio Insurance Commissioner of the State of West Virginia, and relates unto the Court that he has this day heretofore filed a motion with respect to an order or decree of this Court entered on August 9, 1941, and he herewith states unto the Court that the facts therein set up shall be considered as facts set up in this motion and for the purpose of this motion, in so far as they relate thereto.

Your petitioner further says that under and by virtue of the insurance laws of the State of West Virginia, as set out in Chapter 33 thereof, and by virtue particularly of Section 45 of Article 2 of said Chapter 33, on April 11, 1941, in his opinion, the debtor herein became insolvent or was in such financial condition as not to be able to pay its creditors in this State, and he thereupon filed his bill in the Circuit Court of Kanawha County for the administering of the assets of the debtor as an insolvent, and for the purpose of taking possession of its property in this State and the distributing of its assets among those entitled thereto according to their respective rights, as is provided in said Section 45.

Your petitioner further says that thereafter, at his request and suggestion, the Circuit Court of Kanawha County appointed H. Isaiah Smith and Ross B. Thomas receivers of said company for the purpose of taking possession of its property in this State, and that said West Virginia State Court Receivers did thereafter take possession of, to-wit, $700,000.00 of assets in the State of West Virginia as property of the debtor herein.

Your petitioner further relates unto the Court that by virtue of the turn-over orders of this Court entered on June 6th and June 10th, 1941, and confirmed by the order of this Court of August 9th, 1941, those West Virginia State Court [fol. 304] Receivers did turn over that property of the debtor which they had taken into possession, as agents of

your petitioner, to the Central Trust Company, Trustee of the debtor herein, but nevertheless under written protest, which written protest is as follows:

"Ross B. Thomas and Isaiah Smith, Receivers of Fidelity Assurance Association, by virtue of an order of the Circuit Court of Kanawha County, West Virginia, entered on the 11th day of April, 1941, and acting as Receivers since said date, under the direction of said Court, and by reason of said order, and said Receivers having been served with a copy of an order entered by the United States District Court for the Southern District of West Virginia on June 6, 1941, requiring them to turn over all property and assets of the Fidelity Assurance Association in their possession or under their control to Central Trust Company, Trustee in Bankruptcy, appointed in said order of June 6, 1941, by said United States District Court, and further ordering and requiring them to refrain from any further acts or action with respect to their said appointment as Receivers, do hereby, over their objection and protest, obey said order, nevertheless stating and believing said order not to be a valid one, but to be void and of no legal effect, and further stating that they obey said order only and for no other reason than that they be not compelled to take the risk of being held to be in contempt of said United States District Court for failure to obey its orders; nevertheless reserving unto themselves, as Receivers, all of their legal rights and privileges, including the right to test the legality and validity of said order of June 6, 1941, the jurisdiction of said United States District Court in entering said order and in all other matters arising by virtue of the institution of the proceedings in which said order was entered."

Your petitioner relates unto the Court that by virtue of the laws of the State of West Virginia and the proceedings related hereunder, the said West Virginia State Court Receivers were agents of your petitioner for the purpose of taking possession of the property of the debtor in the State of West Virginia, and that such possession was in fact and effect the possession of your petitioner, and that the turnover orders were in fact and effect directed against your petitioner as an official of the State of West Virginia in his official capacity, and therefore against the Sovereign State of West Virginia, and as such were prohibited by the Eleventh Amendment to the Constitution of the United States.

Your petitioner relates, upon information and belief, that with the exception of the receivers appointed for a small amount of property in the State of Ohio, no other state court receivers or statutory officials in any state have made any turn-over to the trustee of the debtor herein, except those agents of your petitioner, to-wit, the West Virginia State Court Receivers.

Therefore, your petitioner alleges that the said turn-over orders of June 6th and June 10th, as confirmed by the order of August 9th, 1941, made against H. Isaiah Smith and Ross B. Thomas, were in fact and effect made against your [fol. 305] petitioner as the principal of them, his agents, and were in fact and effect made against the Sovereign State of West Virginia, and interfered with the official discretion of your petitioner in his representative capacity as an official of the State of West Virginia, and were therefore prohibited by the Eleventh Amendment to the Constitution of the United States.

Wherefore, your petitioner moves this Court that said turn-over orders, in so far as they affect your petitioner by and through his agents, the West Virginia State Court Receivers, be rescinded, and that the Central Trust Company, trustee herein, be required to turn back all of the property, securities and assets heretofore turned over to it by the said West Virginia State Court Receivers to the said West Virginia State Court Receivers, and that the said injunction of August 9th, 1941, in so far as it affects the said West Virginia State Court Receivers and their possession of the said funds, assets and securities, be dissolved.

Edgar B. Sims, Auditor and Ex-Officio Insurance Commissioner of the State of West Virginia, By Clarence W. Meadows, Attorney General, and Ira J. Partlow, Assistant Attorney General, of the State of West Virginia. (S) Clarence W. Meadows.

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[fol. 306] IN UNITED STATES DISTRICT COURT

[Title omitted.]

MOTION OF H. ISAIAH SMITH AND ROSS B. THOMAS, WEST VIRGINIA STATE COURT RECEIVERS—Filed October 27, 1941

This 27th day of October, 1941, came H. Isaiah Smith and Ross B. Thomas, West Virginia State Court Receivers

of Fidelity Assurance Association, and relate unto the Court that they have been advised of the motions heretofore this day filed by Edgar B. Sims, Auditor and Ex-Officio Insurance Commissioner of the State of West Virginia, and that they adopt the facts as set out in said motions as a part of this motion.

Your petitioners respectfully adopt in full the motion of Edgar B. Sims, Auditor, etc., as it affects or purports to affect them, and join in the motion of said Edgar B. Sims, Auditor, etc., that the said turn-over orders and the said injunctive order as it concerns them as West Virginia State Court Receivers and as agents of the said Edgar B. Sims, Auditor, etc., be rescinded and dissolved, and that the Central Trust Company, trustee of the debtor herein, be required to turn back to them all of the funds, assets and securities heretofore turned over to it by your said petitioners because and by virtue of said turn-over orders and injunction.

H. Isaiah Smith and Ross B. Thomas, West Virginia State Court Receivers, By: Koontz & Koontz, Counsel for said West Virginia State Court Receivers. (S.) Koontz & Koontz.

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[fol. 307] IN UNITED STATES DISTRICT COURT

[Title omitted.]

ORDER—October 29, 1941

This cause coming on for hearing on the motion of Don H. Ebright, Treasurer of State of the State of Ohio, and having been argued by counsel and submitted to the court and the court having carefully considered same;

It is ordered with respect to the turnover orders entered by this court on the 6th day of June, 1941, the 10th day of June, 1941, and the 9th day of August, 1941, and all orders heretofore entered herein in any way modifying or affecting the same are hereby interpreted and declared by the court with respect to the securities deposited by the debtor herein with the Treasurer of State of the State of Ohio for the benefit of contract holders, that the said Treasurer of State of the State of Ohio be not required by virtue of said orders to turn over physical possession of such securities

to the trustee of the debtor herein until such time as a plan for reorganization has been regularly adopted and approved by this court and approved by the creditors of the debtor under the provisions of Chapter 10 of the United States Bankruptcy Act.

Whereupon, said Don H. Ebright, Treasurer of State of the State of Ohio, withdraws his answer, petition and motion heretofore filed herein. Said Treasurer of State of the State of Ohio, however, reserves his respective status as an intervenor in these proceedings and his right to participate as such herein.

Entered this 29th day of October, 1941.

Ben Moore, United States District Judge.

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(The Motion, referred to in the foregoing order, is in the words and figures as follows:)

[fol. 308] IN UNITED STATES DISTRICT COURT

[Title omitted.]

MOTION—Filed October 29, 1941

Now comes Don H. Ebright, Treasurer of State of the State of Ohio, and moves the Court for an order interpreting and declaring with respect to the turnover orders entered in this court on the 6th day of June, 1941, the 10th day of June, 1941, and the 9th day of August, 1941, and all orders heretofore entered herein in any way modifying or affecting the same so as to permit the Treasurer of the State of Ohio to retain physical possession of securities deposited with him for the benefit of contract holders until such time as a plan of reorganization has been regularly adopted and approved by the court and approved by the creditors under the provisions of Chapter 10 of the United States Bankruptcy Act.

(S.) Don H. Ebright, Treasurer of State of the State of Ohio. By Thomas J. Herbert, Attorney General. Dale Dunifon, First Assistant Attorney General. David M. Spriggs, Assistant Attorney General.

[fol. 309] IN UNITED STATES DISTRICT COURT

[Title omitted]

ORDER APPROVING DEBTOR'S PETITION, ETC.—January 5, 1942

Upon the petition of the Debtor, Fidelity Assurance Association, praying for its reorganization under Chapter X of the Federal Bankruptcy Act, filed herein on June 6, 1941, and upon the answers of the intervenors, Edgar B. Sims, Auditor and ex officio Insurance Commissioner of the State of West Virginia, Ross B. Thomas and H. Isaiah Smith, Receivers appointed by the Circuit Court of Kanawha County, West Virginia, and upon the answers and pleadings of all other intervenors and creditors controverting the allegations of the petition of the Debtor, and upon the evidence introduced herein, and upon all papers filed and proceedings had herein, the Court is satisfied and doth find that the said petition complies with the requirements of Chapter X of the Federal Bankruptcy Act, that the material allegations of the said petition are sustained by the proofs and that the said petition has been filed in good faith, and now it is

Ordered that the said petition of the Debtor, Fidelity Assurance Association, praying for its reorganization under Chapter X of the Federal Bankruptcy Act, be and the same is hereby approved; and it is further

Ordered that the Court's findings of facts and conclusions of law are as set forth in the opinion of the Court, delivered in open Court January 3, 1942, and the said opinion be and the same is hereby made a part of the record in this proceeding as though fully set out herein; and it is further

Ordered that the motions of Edgar B. Sims, Auditor and ex-officio Insurance Commissioner of the State of West Virginia, Ross B. Thomas and H. Isaiah Smith, Receivers appointed by the Circuit Court of Kanawha County, West Virginia, and John B. Gontrum, Insurance Commissioner of Maryland, and of other intervenors to modify or rescind the orders of June 6, 1941, June 10, 1941 and August 9, 1941 be and the same are hereby overruled; and it is further.

Ordered that the transcript of testimony prepared by the court reporter and filed with the Clerk of this Court [fol. 310] is hereby made a part of the record of this case.

Enter:

Ben Moore, Judge.

January 5, 1942.

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(The Opinion of the Court, referred to in the foregoing order, is in the words and figures as follows:)

[fol. 311] IN UNITED STATES DISTRICT COURT

In Proceedings for Corporate Reorganization

No. 4514

In the Matter of: FIDELITY ASSURANCE ASSOCIATION, Debtor

OPINION—Filed January 5, 1942

On June 6, 1941, Fidelity Assurance Association filed its petition under Chapter X of the Chandler Act, as debtor, praying for corporate reorganization. After an ex parte hearing, the court intered an order approving the petition, enjoining various persons including receivers theretofore appointed by State courts, both in and outside the State of West Virginia, from disposing of any of the property of the Debtor; appointing Central Trust Company of Charleston, West Virginia, as trustee for the Debtor, and requiring the receivers to turn over to the trustee all property of the Debtor in their hands. On June 10, 1941, the court further ordered all state officials, both in and outside the State of West Virginia, having in their possession, custody or control any of the Debtor's property, to deliver such property to the trusteee, and on the same day the court fixed the 5th day of August, 1941, as the date for a plenary hearing on the Debtor's petition. Ross B. Thomas and H. Isaiah Smith, Receivers appointed by the Circuit Court of Kanawha County, West Virginia, delivered to the trustee under protest the property of the Debtor in their possession. The Ohio receiver turned over to the trustee without protest, the property of the Debtor in his possession.

Edgar B. Sims, Auditor and ex-officio Insurance Commissioner of the State of West Virginia, Ross B. Thomas

and H. Isaiah Smith, the West Virginia Receivers, and various other state court receivers and state depositaries of securities of the Debtor outside the State of West Virginia, as well as certain groups of creditors, were permitted to intervene and file answers controverting the allegations of Debtor's petition.

The hearing which began on August 5, 1941, was continued from time to time until the 10th day of October, 1941, during which time nearly 4,000 pages of testimony were taken and 123 exhibits filed, at the conclusion of which hearing the court heard the argument of counsel upon the questions at issue.

[fol. 312] During the course of the hearing, on August 9, 1941, the court entered an order modifying the orders of June 6, 1941, and June 10, 1941, so as to eliminate therefrom any requirement that property of the Debtor in possession, custody or control of any state official on April 11, 1941, should be turned over or delivered to the Debtor's trustee in this proceeding. The West Virginia Insurance Commissioner, the receivers appointed by the Circuit Court of Kanawha County, West Virginia, and the Insurance Commissioner of Maryland, who appeared specially for that purpose, filed motions that the orders of June 6, 1941, and June 10, 1941, be further modified by eliminating all injunctive provisions against them, respectively, on the ground, substantially, that the effect thereof is to subject sovereign states to suit contrary to the provisions of the Federal Constitution; and as to property already delivered by the receivers to the trustee, that the orders be rescinded and the trustee required to return such property.

The case is now submitted to the court upon the questions (1) whether Debtor's petition shall be approved or dismissed, (2) whether the injunction "freezing" deposits in the hands of state depositaries should be dissolved, and (3) whether the orders requiring receivers to turn over certain assets of the Debtor in their hands to the Central Trust Company as Trustee of the Debtor should be rescinded.

## Statement of Facts

Debtor was incorporated under the laws of the State of West Virginia on April 26, 1911, under the name of Fidelity Investment & Loan Association. Its objects and purposes as set forth in its original charter were to engage

in a general brokerage business in securities, real estate and insurance; and for a period of approximately a year and one-half it carried on a general brokerage business. In November, 1912, it changed its name to Fidelity Investment Association and amended its charter so as to provide for conducting "the business of soliciting and receiving deposits and payments on any annuity contracts, certificates or annuity bonds." This charter amendment brought the company under the provisions of what is now Article 9 of Chapter 33 of the Code of West Virginia relating to [fol. 313] annuity contracts. Since the change of name and amendment of the charter in November, 1912, Debtor has been engaged solely in the business of selling its own securities in the form of investment contracts or bonds of various types and the investment of the funds received from purchasers of such contracts so as to provide for their payment at maturity, according to their terms, or for payment of specified cash values at various stages in the life of the individual contract, if required by the purchaser. If a purchaser paid all the installments of his contract to maturity, he received a net return on the money invested which ranged from 1.55% to 3.09%, depending on the type of contract. The cash values were so fixed that it was not until the purchaser had paid all of the first year's installments that his contract was given any cash value whatever. Thereafter it acquired a cash value which increased proportionately as the years passed; but the cash value did not equal the total amount paid in by the purchaser until the end of a period varying from six to nine years, again depending on the type of contract. Contracts were matured when monthly installments had been paid for a period of ten to eleven years with a subsequent waiting period of three to thirteen months. About the year 1934 Debtor began issuing a contract known as Series B contract, the sale of which from that time on constituted the major portion of Debtor's business. Series B contracts were issued and sold in two forms. One of these contained a provision commonly referred to as Section 6, by the terms of which it was agreed that the Debtor would protect the unpaid portion of those contracts containing Section 6 by procuring an insurance policy which would provide that the contract of any purchaser who died before the maturity of his contract and while the same was in good standing would be paid to maturity (or the commuted value of a

paid up contract would be paid to the purchaser's estate) without further payment of any monthly installments. The net return to the purchaser of this Series B contract containing Section 6, after allowing for the amounts deducted to pay the premiums on the insurance, was 1.55%.

While the various types of investment contracts sold by the Debtor differ in some respects, they are all alike in providing for monthly, semi-annual or annual payments of specified sums, of which a sufficient portion was to be set aside in a reserve fund which was to produce the sum required to pay the purchaser the amount of money agreed [fol. 314] upon in the contract. The earlier contracts contained no statement as to the basis of the reserve fund. Of the later contracts, some provided for reserves on a 4½% basis and some on a 4% basis. All provided that the reserve fund so set aside should "be invested in approved securities and deposited in trust as required by the laws of the State of West Virginia."

During the course of its history, the Debtor expanded its business to a point where it was conducting operations in no fewer than 29 states. Section 3 of Article 9 of Chapter 33 of the Code of West Virginia provides that companies such as the Debtor, as a condition to receiving a license to transact business in the State of West Virginia, must deposit with the state treasurer in trust for the benefit of its contract holders securities approved by the Insurance Commissioner of West Virginia, in the amount of $100,000.00 "and, in addition to such deposit • • • shall maintain at all times a deposit with the State Treasurer • • • to an amount equal to the total amount" for which the corporation may be liable in cash to the holders of all contracts at any particular time. It is further provided that where other states require the corporation to make deposits therein to secure contract holders in such other states, the amount of deposits made in the other states may be deducted from the total amount required to be deposited with the Treasurer of the State of West Virginia. Some of the other states in which Debtor transacted business required deposits of securities to be made, while others did not. The other states requiring deposits were Wisconsin, Illinois, Ohio, Tennessee, Missouri, Maryland, Alabama, Delaware, Indiana, Iowa, Kansas, Kentucky, Pennsylvania and Virginia. The provisions

of the several state laws with reference to the amount of required deposits vary. For example, under the law of Wisconsin it is provided in effect that Debtor's outstanding contracts in that state may not exceed 90% of the value of the deposit required to be maintained in that State; while Maryland requires deposits in an amount at least equal to contract liabilities with a minimum of $25,000.00, and Illinois requires the same with a minimum of $50,000.00. Virginia requires a deposit of $25,000.00, without regard to the amount of cash liabilities, of which Debtor [fol. 315] has outstanding in Virginia approximately $550,000.00. The deposit provision of the Illinois law was enacted in 1931. Prior to that time no deposit was required in Illinois; but the Debtor had sold its contracts in that state and had substantial cash liabilities outstanding there. Consequently the deposits made by the Debtor with the State of Illinois never equalled the total cash liabilities in that state. Deposits of securities were made by the Debtor with the Treasure of the State of West Virginia to the total value, as of June 6, 1941, of more than $10,000,000.00 on a market value basis, approximately $12,000,000.00 on a "sound" value basis, and about $14,000,000.00 on the basis of "book" value. At that time the total cash liabilities of the Debtor to West Virginia contract holders were approximately $2,000,000.00. The excess above that figure, by the provisions of the West Virginia deposit statute, was for the protection of contract holders in states which required no deposit, as well as in states where the deposit was less than the total cash liabilities.

In each of the contracts sold by the Debtor there was a provision, which is set out in the respective contracts as Section 1 thereof, whereby, with slight variation in language as to each particular class or series of contracts, the Debtor agreed to create and maintain a reserve fund for such particular class or series from payments made on contracts of that particular class or series, which reserve fund was to be used for the discharge of its liabilities on that particular class or series of contracts. On its books Debtor kept these various series funds separate and distinct, but prior to December 31, 1938, it deposited cash received from payments on all the different series of contracts except Series "B" and Series "D" in one bank account. Payments on contracts in Series "B" and Series "D" were deposited in separate bank accounts from their inception.

At times when the reserve fund in one series was impaired by reason of withdrawals and maturities, so called "inter-fund" loans were made, of which exact records were kept and on which interest was charged to the borrowing fund and paid to the lending fund. In making the deposits with various state depositories, Debtor did not at all times designate deposited securities as being owned by particular funds, and made no attempt to proportion its deposits of securities from a particular fund to the amount of cash [fol. 316] liabilities against that fund in the state where the securities were deposited. It is contended by some of the parties to this proceeding that as a result of this method of doing business, each of the separate series funds is a trust fund for the benefit of the holders of contracts in that particular class or series, regardless of the provisions of the various state deposit laws, which might otherwise be applicable. A decision on this point is not necessary to a determination of the issues now being considered by the court, but the facts are set out, inasmuch as they were developed at the hearing.

In the period following the year 1929 occured a great financial depression. The market value of securities fell substantially and Debtor's affairs became precarious, to say the least. When Auditor Sims took office in the year 1933 the entire assets of the company on a basis of market values were worth about $7,000,000.00 less than the amount of its cash liabilities. Gradually, by reason of an investment policy which took advantage of market fluctuations in certain securities, together with a general improvement in market values, the Debtor's financial condition improved. At the time the petition was filed the market value of the Debtor's assets was approximately $2,500,000.00 less than its cash liabilities.

On December 14, 1938, the Securities and Exchange Commission instituted an action against the Debtor in the District Court of the United States for the Eastern District of Michigan, Southern Division at Detroit, as a result of which, and by consent of the Debtor in open court, an injunction was entered against the Debtor and its principal officers enjoining certain practices in which the Debtor and its agents had theretofore engaged in connection with the sale of its investment contracts. Thereafter, and chiefly as a result of the Detroit proceedings,

certain contract holders brought suit in the United States District Court for the Northern District of West Virginia, praying for the appointment of a receiver for Debtor's property and assets on the theory that Debtor was at that time insolvent. The court adopted the view that "sound" values instead of market values should be used as a basis of appraising Debtor's solvency and held that Debtor on that basis was not insolvent, dismissing the proceeding. The Circuit Court of Appeals affirmed the District Court's decision. The publicity which resulted from the injunction [fol. 317] and the litigation in the Northern District of West Virginia caused a substantial loss of public confidence and was greatly detrimental to Debtor's business. However, Debtor continued to operate until the passage of the Investment Company Act in the fall of 1940, when it became apparent that Debtor could not continue to do business as in the past because it would be unable to comply with the conditions and provisions of that Act.

In this situation Debtor attempted to devise means of continuing its business on a reorganized basis. The officers and directors conceived the idea that it might be converted into an insurance company, retaining at the same time the power and right to issue annuity contracts as it had theretofore done, and that by a combination of life insurance features with the investment contracts, or by conversion of the contracts into life insurance policies or into annuities, Debtor might be able to continue to do business. Accordingly the charter was amended as of December 31, 1940, so as to provide that the corporate objects and purposes thereafter were "to issue insurance upon the lives of persons and every insurance appertaining thereto and connected therewith and to grant, purchase and dispose of annuities." Auditor Sims issued a license to the Debtor as so reorganized, but required of the Debtor that it do no soliciting by virtue of this license; so that the only business transacted by the Debtor after December 31, 1940, was the receiving of installment payments on contracts theretofore sold, paying off matured contracts and contracts presented for payment of their cash value, making loans on contracts and receiving payments thereon, and dealing with and managing the securities in its portfolio.

On April 4, 1941, Auditor Sims directed the Debtor to cease doing business of any kind and to "freeze" its assets

as of that date; that is, Debtor would continue to receive payments being sent in by purchasers of contracts, but it was ordered by Sims to segregate these payments and to apply none of them towards improvement of the contracts, neither was it permitted to make any further payments on matured contracts or upon any contract surrendered by a purchaser for its cash value, nor to make any further contract loans, nor to dispose of any securities held by the Debtor. One week later, on April 11, 1941, Auditor Sims, as Commissioner of Insurance, filed a bill in the Circuit Court of Kanawha County, West Virginia, pursuant to the [fol. 318] provisions of Section 45, Article 2, Chapter 33 of the Code of West Virginia, which section provides that such action may be taken by the Insurance Commissioner "for the purpose of taking possession of its (any insolvent investment company's) property in this State and the distribution of its assets among those entitled thereto according to their respective right." The Circuit Court of Kanawha County appointed Ross B. Thomas and H. Isaiah Smith as special receivers of the property and assets of the Debtor in West Virginia. These receivers took into their possession all tangible property of the Debtor in West Virginia and all its intangible property in West Virginia, except the securities which had been deposited by the Debtor with the State Treasurer under the provisions of Section 3 of Article 9, Chapter 33 of the Code of West Virginia, already referred to. The securities in the hands of the State Treasurer had a market value at that time of approximately $10,000,000.00 and constituted more than 50% in market value of the total security deposits maintained by the Debtor in all states requiring deposits, and almost 50% of all assets of the Debtor.

After the appointment of the receivers by the Circuit Court of Kanawha County, West Virginia, most of the other states wherein the Debtor maintained deposits under the provisions of the applicable state laws began proceedings looking toward the liquidation of the deposits in those states. For the most part, these proceedings took the form of the appointment of receivers by the respective state courts under statutes similar in purpose to the West Virginia statute under which Auditor Sims had acted. No securities were actually sold, except in the State of Wisconsin, where the Banking Commission, acting under the

authority of a Circuit Court order, sold approximately $1,250,000.00 of securities which had been deposited by the Debtor in that state, being about one-half the total deposit in Wisconsin.

At the annual stockholders' meeting of the Debtor in February, 1941, fourteen directors were elected, but six of these had declined to serve. On June 3, 1941, a purported meeting of the directors was held in Pittsburgh, Pennsylvania, at which meeting six of the eight directors who had been elected and who had consented to serve were present. There were Allen G. Messick, John Marshall, John Marshall, Jr., A. L. King, Howard E. Reed and F. H. Pulfer. [fol. 319] D. A. Burt and F. S. Risley, the other two of the eight directors who had consented to serve, were not present. The by-laws of the Debtor provide that seven directors shall constitute a quorum, and further that "vacancies in the board of directors not caused by removal by stockholders in gener meetings may be filled for the remainder of the term by vote of a majority of all of the directors in office. * * *." James R. Fleming, a friend of John Marshall, Sr., was present when the six directors met in Pittsburgh, and these six directors proceeded to elect him as a seventh director for the purpose of establishing a quorum, he having announced his intention to resign from the board upon adjournment of that meeting. At this meeting in Pittsburgh a resolution was passed authorizing John Marshall, Jr., on behalf of the company to file the petition for corporate reorganization under Chapter X, which is the basis of this proceeding. The petition was filed by Fleming as attorney for the Debtor. The controverting answers filed challenge the validity of the Pittsburgh directors' meeting on the ground that a quorum was not present and on the further ground that several of the directors who were present were inelgible to serve as such, because of the fact that they had been enjoined in the Detroit proceeding. The Investment Company Act of 1940 provides (U. S. C. A. Title 15, §80 a-9) that it shall be unlawful for any person to serve as a director of a company who "by reason of any misconduct, is permanently or temporarily enjoined by order, judgment, or decree of any court," etc., from acting in various capacities in connection with the business of an investment company.

The validity of the directors' meeting of June 3, 1941, having been questioned, a subequent directors' meeting was held on September 17, 1941, at which directors' meeting the minutes show the presence at the beginning of seven directors, namely, Allen G. Messick, John Marshall, John Marshall, Jr., Howard E. Reed, F. H. Pulfer, D. A. Burt and Wheeler Bachman. These directors elected Phil D. Paull to fill the place of A. L. King, resigned, and ratified and confirmed the action taken on June 3, 1941, authorizing the filing of the petition. The validity of this meeting is likewise questioned, both because Wheeler Bachman was present and acted as one of the seven directors to make a quorum, he having previously in a letter to the Debtor [fol. 320] declined to act as a director, but no action having been taken thereon by the company, and because certain others of the directors are alleged to be disqualified by the aforesaid provisions of the Investment Company Act of 1940.

A third effort was made by the Debtor to validate the original action of the board on June 3, 1941, with reference to filing the petition. A meeting of stockholders was held on October 3, 1941. At this meeting a resolution was adopted by the stockholders ratifying the filing of the petition; vacancies in the offices of directors were filled; the by-laws were amended to provide for a quorum of five instead of seven; and a directors' meeting was thereupon held, at which thirteen members of the board as then constituted were present; and a similar resolution of ratification was unanimously adopted. Those present were: Allen G. Messick, F. H. Pulfer, John Marshall, John Marshall, Jr., D. A. Burft, Philip D. Paull, James Paull, F. S. Risley, W. L. Burt, Gordon Hobstetter, George Miller, H. Julian Ulrich, and H. C. Hazlett. Seven of the directors present at this last meeting were not affected by the provisions of the Investment Company Act of 1940 already referred to. Opponents of the petition object to the validity of the last mentioned stockholders' and directors' meetings on the ground that John Marshall, Sr., was permitted to vote the majority of the stock of the company at the stockholders' meeting, pursuant to a voting trust agreement which was originally entered into in connection with some refinancing efforts made by the company which failed of their purpose; and it is contended that the owners of the stock should have been permitted to vote it at the stockholders' meet-

ing. Objection is also made that the court abused its discretion in consenting, prior to the meeting of stockholders and directors, that certain persons should be elected as officers of the company who, it is alleged, are still subject to disqualification, because of the Detroit injunction.

Shortly after the petition was filed, the trustee petitioned the court for authority to employ Allen G. Messick and James R. Fleming to assist the trustee in certain matters in which interested persons might be employed under the provisions of Chapter X. The court at first authorized [fol. 321] such employment, but later, being of opinion that it would not be for the best interests of all parties concerned, revoked such authority and Messick and Fleming were never actually employed by the trustee. Opponents of the petition contend that the acts of John Marshall, Sr., Allen G. Messick and James R. Fleming, all of whom participated in the directors' meeting of June 3, 1941, which authorized the filing of the petition, together with other circumstances developed at the hearing, show a lack of good faith independently of the statutory standards set out in Section 146 of Chapter X.

The arguments, therefore, which are advanced by opponents of the petition are, first, that the debtor is an insurance company and therefore ineligible to file a petition for reorganization under Chapter X; secondly, that no valid authority was given for the filing of such petition; thirdly, that the securities in the hands of the State Treasurer of West Virginia, amounting to approximately Ten Million Dollars in market value, are not assets of the Debtor within the meaning of the venue provision of Chapter X and that since no other assets of the Debtor are within the territorial jurisdiction of this court, this was not the proper venue for the filing of the petition; and fourthly, that the petition of the Debtor was not filed in good faith, either within the ordinarily accepted meaning of the term, or within the restrictions set out in Section 146 of Chapter X; and that under the provisions of Section 146 it is unreasonable to expect that a plan of reorganization can be effected; and that the prior proceeding in the Circuit Court of Kanawha County, West Virginia, would best subserve the interests of creditors and stockholders. It is further contended as bearing on the unreasonableness of any expectation that a plan of reorganization can be effected, that even though this court should be held to have both juris-

diction and venue of the proceeding as such, still it would lack authority by reason of the 10th and 11th amendments to the constitution of the United States to enter any order against any of the state depositaries having in their possession securities deposited by the Debtor, as well as against the Kanawha County Circuit Court receivers, who, it is alleged, are merely agents of Auditor Sims; and further that the deposits made by the Debtor with various state depositaries constitute contracts in the public authority which the court may not reject or interfere with; and that lacking such authority the court could not possibly provide [fol. 322] for the carrying out of any effective plan of reorganization. I will now proceed to examine these arguments.

## Conclusions of Law

Is the Debtor an insurance company?

It is contended by opponents of the petition that even prior to December 31, 1940, the nature of the Debtor's business was such that it should be denominated an insurance corporation within the meaning of Section 4 of Chapter III of the Bankruptcy Act, which is also applicable to Chapter X; and further, that upon amendment of its charter on December 31, 1940, it became an insurance company, both in name and in fact, and was therefore ineligible to file a petition for reorganization under Chapter X. I am of opinion that prior to the charter amendment of December 31, 1940, Debtor's business had none of the distinguishing features which characterize an insurance company. Originally it was organized as a brokerage company to deal as a broker in securities, real estate and insurance. When its charter was first amended in November, 1912, it was for the purpose of enabling it, as stated in the charter amendment, to engage in "the business of soliciting and receiving deposits and payments on any annuity contracts, certificates or annuity bonds." The contracts which it sold throughout its subsequent existence until it ceased selling any contracts whatever were not insurance annuity contracts. They were investment annuity contracts. An essential element of any insurance contract is that the insurer, as one of the conditions of the contract and as consideration, at least in part, for the periodical payment of premiums, assumes some risk of being required to pay the beneficiary a larger sum of money than the amount, with

interest, paid in. In life insurance this risk takes the form of an agreement to pay a sum of money, contingent upon the death of the person insured; in accident insurance, upon the happening of an accident to the person insured; in title insurance, upon suffering of a loss by the person insured from defective title; in marine insurance, upon loss of an insured cargo, etc., *Howard Fire Insurance Company v. Chase*, 72 U. S. (5 Wall) 509, 18 L. Ed. 524; *Ogilvie v. Knox Insurance Company*, 63 U. S. (22 How.) 380, 16 L. Ed. 349. In none of Debtor's contracts did Debtor assume any such risk, or, in fact, any risk. Even in the Series B contracts [fol. 323] with the insurance provisions, it is quite clear that Debtor itself assumed no risk, but merely agreed to keep those contracts insured as to unpaid installments, which it did by procuring an insurance policy from the Lincoln National Life Insurance Company. Clearly, Debtor was an investment company and not an insurance company prior to December 31, 1940.

By the charter amendment of December 31, 1940, Debtor became empowered (subject to the licensing authority of the State of West Virginia) both the issue life insurance contracts and to grant, purchase and dispose of annuities. In view of the fact that this charter amendment was a step in an attempted reorganization of Debtor's business and that it had outstanding at that time many thousands of the investment annuity contracts described in its first charter amendment as "annuity contracts, certificates or annuity bonds," I am of opinion that the term "annuities" as used in the 1940 charter amendment referred to the same kind of investment annuity contracts which were then outstanding. In order that Debtor might entertain any reasonable hope of reorganization, it was necessary that it continue to enjoy the power to "purchase and dispose of annuities", whether such annuities were to be those already outstanding or annuities afterwards sold. True, Debtor's directors had decided that it could not continue business in the same manner as in the past, because it could not qualify under the Investment Company Act of 1940; but they hoped that by a combination of its business in investment annuity contracts with a life insurance business, the company might continue to operate. The precise plan of operation had not been determined upon at the time the Debtor was placed in receivership in the Circuit Court of Kanawha County, West Virginia, on April 11, 1941.

In deciding whether a corporation is to be classified as an insurance or banking corporation or a building and loan association within the meaning of the Bankruptcy Act, the court must first examine the provisions of its corporate charter. If the charter authorizes the company to engage in business in any of the excepted fields, and if the company in fact engages principally in a business which lies within that field, such a corporation must be treated as one excluded from the benefits of Chapter X. However, if its charter authorizes the corporation to engage in activities [fol. 324] outside the excepted fields, and if all the business actually done by the corporation is outside those fields, then it must be treated as not being within any of the excluded classes. By this test Debtor must be classified as a corporation which is not an insurance corporation within the meaning of the exemption provisions of the Bankruptcy Act. It is a corporation which is entitled to the benefits of Chapter X, and it had the right to file a petition for corporate reorganization. *In re: Supreme Lodge of Masons Annuity*, 286 F. 180; *In Re: Wisconsin Co-operative Milk Pool*, 35 F. Supp., 787; *In Re: Prudence Company*, 79 F. (2d) 77 (2 C. C. A., 1935); *Finletter, The Law of Bankruptcy Reorganization*, (1939) p. 107; *Capitol End. Co. v. Kroeger*, 86 F. (2d) 976, 979 (6 C. C. A. 1936).

Was the petition which Debtor filed on June 6, 1941, properly authorized?

The directors' meeting in Pittsburgh, held on June 3, 1941, at which meeting John Marshall, Jr., was authorized by resolution to file the petition for corporate reorganization, was attended by only six directors. The by-laws of the Debtor specify that seven directors are required to constitute a quorum. Eight of the directors elected at the annual meeting had consented to serve. It is clear that the directors' meeting in Pittsburgh was held without a quorum. The fact that the six directors who were present elected a seventh to complete the quorum does not change the situation. If a valid meeting could be held by six directors, there is no reason why it could not be held by any other number less than a quorum. Such procedure, if given the sanction of the court, would render nugatory the provision of the by-laws with reference to a quorum. The purported directors' meeting of June 3, 1941, was not a legal meeting and the directors could not at that meeting grant

any valid authority to any person to file the petition for reorganization. *Lawrence, et al. v. Montgomery Gas Company*, 88 W. Va., 352, 106 S. E. 890. Unless it can be said that the defective proceedings and the act of Marshall pursuant thereto in filing the petition were afterwards properly ratified by the Debtor, they established no basis for this proceeding.

On September 17, 1941, another directors' meeting was held in Charleston, West Virginia, at which meeting were [fol. 325] present seven of the persons who had been elected as directors of the Debtor at the annual meeting held in February, 1941. One of these persons, namely, Wheeler Bachman, had previously written a letter to the corporation declining to serve as a director, but no action had been taken thereon by the corporation. It is an elementary principle of law that one who resigns an office may recall or revoke his resignation at any time before it is accepted. It is not shown that Bachman ever formally resigned; but if we treat his letter as a resignation, his attendance at the directors' meeting of September 17, 1941, and his participation therein are sufficient evidence of his intention to revoke such resignation. He had the right to claim his office as director, at least when no other director objected, and his acts as such were valid. One objection to the validity of the directors' meeting of September 17, 1941, as well as to that of the prior meeting of June 3, 1941, is that certain of the directors were disqualified because the injunction which had been granted against them in December, 1938, was still in effect, and because the Investment Company Act of 1940 makes it unlawful for any person to serve as a director of a company who "by reason of any misconduct" is enjoined from acting in certain capacities covered by the 1938 injunction. I am of opinion that the fact that certain of these directors may have violated the law in serving as such directors would not render their acts as directors invalid. Moreover, all of the directors who were enjoined had filed applications for exemption with the Securities and Exchange Commission, as provided for in the Investment Company Act of 1940; and while exemptions had not been granted, neither had they been denied, and these persons had been serving as officers and directors of the Debtor with the knowledge of the Securities and Exchange Commission and without objection. There could have been no valid ac-

tion on the part of the directors of the Debtor without the participation of at least some of these allegedly disqualified persons, since their exclusion from participation would have reduced the number of directors below the number necessary for a quorum. I am of opinion that the directors' meeting of September 17, 1941, was valid. In view of that conclusion, it is unnecessary to consider the question of the validity of the meeting of stockholders and directors subsequently held on October 3, 1941; but I may properly [fol. 326] say in passing that the October 3rd meetings were in all respects legal. Any act which directors have power to do may be subsequently ratified, if performed in the first instance without authority. *Helvering v. J. L. Brandeis & Sons*, 75 F. (2d) 487 (8 C. C. A. 1935). It follows that the filing of the petition for corporate reorganization, though originally not properly authorized, was afterwards duly ratified, and such ratification was ~~effective~~ as of the date of the original act of authorization.

Is the Southern District of West Virginia the proper territorial jurisdiction for the filing of Debtor's petition for corporate reorganization?

Section 128 of Chapter X of the Bankruptcy Act provides that an "original petition may be filed with the court in whose territorial jurisdiction the corporation has had its principal place of business or its principal assets for the preceding six months or for a longer portion of the preceding six months than in any other jurisdiction." The principal place of business of the Debtor is located in Wheeling, a city in the Northern District of West Virginia. Therefore, unless it can be said that the Debtor had its principal assets in the territorial jurisdiction of the Southern District of West Virginia for a longer portion of the six months next preceding June 6, 1941, than in any other jurisdiction, the petition must be dismissed.

It is undisputed that the securities in the hands of the Treasurer of the State of West Virginia at Charleston, in the Southern District, are of greater value than the securities deposited by Debtor in any or all other states. It is likewise undisputed that virtually all of Debtor's "free" assets, that is, tangible real and personal property and securities not in the hands of any state depositary, were located in the Northern District of West Virginia during the greater portion of the six months preceding June 6,

1941. The only question to be decided, then, insofar as this phase of the inquiry goes, is whether or not the securities in the hands of the Treasurer of the State of West Virginia are assets of the Debtor within the meaning of Section 128 of Chapter X.

It is contended by opponents of the petition that the doctrine of *mobilia sequuntur personam* is applicable to the securities in the hands of the State Treasurer, and that [fol. 327] since Debtor has its principal office in the Northern District of West Virginia, these securities, being intangibles, have their legal situs in the same place. The doctrine of *mobilia sequuntur personam* is a legal fiction. Like all such fictions, it originated from necessity. Its use is limited to those cases in which it is necessary that the doctrine be invoked in order to accomplish some beneficial result and in which, without means of the doctrine, some proper governmental, legal or equitable principle would fail of application. In the absence of such necessity the situs depends upon power of control. The securities in the hands of the State Treasurer are chiefly bonds and certificates of stock. These documents are themselves chattels. Possession thereof gives the court within whose territorial jurisdiction the possession is held power of control over the debt or property right represented by them. *In Re: Berthoud*, 231 Fed. 529 (S. D. N. Y. 1916); *1 Gerdes, Corporate Reorganization*, Section 69.

In addition to the contention that the situs of Debtor's intangible property is in the Northern District of West Virginia, it is further argued by opponents of the petition that the securities deposited with the State Treasurer at Charleston are not assets of the Debtor at all. They say that when these securities were deposited, the State of West Virginia became vested with the legal title therto, and that when Auditor Sims determined on April 4, 1941, that the Debtor was insolvent, or, at the latest when the receivers were appointed by the Circuit Court of Kanawha County, West Virginia, the entire beneficial interest in these securities became vested in the holders of contracts secured thereby and that thereafter the Debtor had no interest of any nature in the securities. I find no provision in any of the pertinent West Virginia statutes which gives to the State Auditor (Insurance Commissioner) or to the State of West Virginia itself any further interest in the deposited

securities than that (1) if the Insurance Commissioner shall be of opinion that the assets of the depositing company are impaired or that it is not complying with the law, he is given authority to revoke its license and to retain the deposits under his authority and control until the total liabilities of the company in the State of West Virginia are redeemed or settled and (2) if the company shall become insolvent, the Commissioner of Insurance is authorized to file a bill in the Circuit Court of Kanawha County for the administering of its assets and the distribution thereof [fol. 328] among those entitled thereto according to their respective right. The language used in the applicable statutes (Code of West Virginia, Chapter 33, Article 9, Section 10; Michie Section 3455, Chapter 33, Article 2, Section 45; Michie Section 3325 (1)) indicates that the legislature intended the deposited securities to be deemed and treated as assets of the company; for in referring to impairment of *assets* and administering of *assets*, it is clear that the legislature meant to include the deposited securities, since under the law these at all times constituted the bulk of the property liable for the company's debts. The mere bringing of a suit and the appointment of receivers do not divest an insolvent corporation of its interest in property which up to that time it owned. The corporation still has an interest in the property to see that it is properly applied in satisfaction of its obligations; and it has the further right to receive whatever portion of the property may remain after all the obligations are satisfied. Such right is not affected by the fact that at the time receivership proceedings were instituted the corporation was insolvent. It is always possible that between the date of the appointment of receivers and the date of the court's final decree of distribution a change in values may produce a surplus over and above the claims of creditors. Auditor Sims testified that the market value of Debtor's securities increased nearly five million dollars between 1933 and 1941, due in part to rising markets; and it is shown by other testimony that the market value of the securities increased substantially between the date the state receivers were appointed and the date of the hearing. It is also possible, and perhaps probable, in this case, since there are approximately 80,000 creditors, that their proved claims may

amount to a total sum substantially less than that shown by Debtor's books of account.

The fact that stockholders of the Debtor had no interest in the assets is immaterial. The test is whether or not the assets may be applied in payment of the Debtor's obligations. *In Re: Central Funding Corporation*, 75 F. (2d), 256 (C. C. A. (2d) 1935); *In Re: Mortgage Securities Corporation*, 75 F. (2d) 261, (C. C. A. (2d) 1935.)

The securities deposited with the Treasurer of the State of West Virginia are liable for the payment of Debtor's obligations. Clearly they are assets of the Debtor within the meaning of Section 128 of Chapter X.

[fol. 329] Was the petition filed in good faith?

Section 146 of Chapter X of the Bankruptcy Act provides that a petition shall be deemed not to be filed in good faith if "(1) the petitioning creditors have acquired their claims for the purpose of filing the petition; or (2) adequate relief would be obtainable by a debtor's petition under the provisions of Chapter XI of this Act; or (3) it is unreasonable to expect that a plan of reorganization can be effected; or (4) a prior proceeding is pending in any court and it appears that the interest of creditors and stockholders would be best subserved in such prior proceeding." Subsections (1) and (2) are not applicable. The greater part of the voluminous testimony taken in the hearing was in relation to Subsection (3). The principal contentions of opponents of the petition are; that the Fidelity plan is fundamentally unsound; that its past history shows that it cannot be operated profitably; that the Investment Company Act of 1940 has made it impossible to operate the Fidelity plan in the future; that the unfavorable publicity which has attended Fidelity's operations during the past three years, including that incident to the present litigation, has created among Fidelity's contract holders a feeling unfavorable to any future operation of the company; and that the various states, if deprived of their asserted right of control over the deposits made therein, respectively, would not be friendly to future operations in those states. I will consider these contentions in the order stated.

The proceedings are not yet at a stage where the court is called upon to consider any particular plan of reorganization. It is true that the broad picture developed by the testimony at the hearing does not present a very favorable view with respect to the rehabilitation and continued opera-

tion of the Debtor as a face amount certificate company. Whether the Fidelity plan is fundamentally unsound depends upon the definition given to the term. It is apparent that it is a plan of investment which yields a very low rate of income to the investor and subjects the investor to substantial loss should he cease to pay the required installments during the earlier stages of the contract; but this very element of weakness from the investor's standpoint strengthens the company from an operating viewpoint, pro-
[fol. 330] vided the contracts can be sold in sufficient volume to take care of necessary overhead expenses. It is extremely doubtful whether, in view of unsettled economic conditions and the critical international situation, the Fidelity plan would any longer appeal to a large public; but it is not impossible; and it is not the duty of the court to decide for the public that investors will not or should not buy these contracts in the future.

The fact that the company has not been operated profitably in the past is not shown to be the result of financial unsoundness in the plan itself. It has been due rather to an unsoundness in Debtor's methods of management. Extravagant sales and promotion expenses; useless expenditures for lavish offices, including the home office building at Wheeling, West Virginia; overexpansion, particularly in states like Wisconsin, where the strictness of regulatory state laws made it impossible to operate at a profit; poor judgment in selection of the personnel to manage the company: these are the elements of unsoundness which have brought about the difficulties in which Debtor now finds itself.

The requirements of the Investment Company Act of 1940, establishing 7% of the total amounts paid in on contracts during their entire life as the maximum loading charge, are calculated to make the contracts more saleable, and, with proper economy and good judgment on the part of the management, a reasonable profit to the operating company is possible. This regulatory law has not had the effect of banishing all such companies from the region of commercial operation. The testimony discloses that at least one other such company is still in operation, presumably with some measure of success.

To conclude that unfavorable publicity concerning the affairs of any company must affect that company's prospects of future operation after being reorganized under

Chapter X is to lose sight of the very purpose of such a reorganization. All the unfavorable publicity has been directed towards the unreorganized company. What I have said above concerning the reasons for the company's present financial condition indicates that in my opinion such unfavorable publicity has been amply justified; but it does not follow that if and when the company may be reorganized under the supervision of a United States Court it [fol. 331] would retain any of the stigmata which it is the purpose of such reorganization to remove.

As to the argument that the several states where Debtor has sold contracts would be unfriendly to future operations of a reorganized company therein, it is sufficient to say that this argument imputes to the governments of those states unworthy motives for future action—motives which no court should assume would be entertained. Certainly if any reorganized company should seek permission to do business in those states, it would be required to comply with the state laws. It could do no less. It should not be expected to do more.

The Debtor is insolvent, on the basis of market values, to the extent of approximately 10%; that is, its liabilities exceed its assets by that figure. This fact furnishes no basis for concluding that it is unreasonable to expect that a plan of reorganization can be effected. One of the essential allegations in a petition for reorganization is "that the corporation is insolvent or unable to pay its debts as they mature." Section 130, Chapter X, Bankruptcy Act. The stockholders may be entirely excluded from the reorganization. *Case v. Los Angeles Lumber Products Company*, 308 U. S. 106.

It is not necessary that there be a reasonable prospect for the successful rehabilitation of the Debtor as a going or continuing corporation. It is sufficient if it is shown that the Debtor is in a position to conform to and obtain the benefits of the statute for a slow, beneficial and orderly liquidation. *R. L. Witters Associates, Inc. v. Ebsary Gypsum Co., Inc., et al.*, 93 F. (2d) 746 (C. C. A. 5th 1938); *Re: Central Funding Corporation*, 75 F (2d) 256 (C. C. A. 2d 1935); *In Re: Mortgage Securities Corporation*, 75 F (2d) 261 (C. C. A. 2d 1935). The character of Debtor's assets is such that it would be peculiarly beneficial in its case to obtain slow and orderly liquidation, if such should be found to be the only feasible plan. The dumping upon the market of twenty mil-

lion dollars worth of securities of the kind held in Debtor's portfolio would most certainly result in substantial losses, which may be avoided by slow and careful liquidation over an extended period of time. The possibility must also be considered that some of the Debtor's outstanding contracts may be found to be secured to the extent of their full cash [fol. 332] value, while others may be found to have less security, and therefore it may be practicable to liquidate the different contracts in different ways and by different methods, or to liquidate some and to effect a continuing reorganization as to others.

The argument that the receivership proceeding pending in the Circuit Court of Kanawha County is one in which the interests of creditors and stockholders would be best subserved, was vigorously urged. Its fallacy is patent. I shall, however, devote some space to its consideration. To say that a court which has jurisdiction only within the bounds of the State of West Virginia could properly deal with assets located in twenty-nine different states is, in my opinion, absurd. Even as to the assets in West Virginia, it is contended by Auditor Sims that the receivers appointed by the Circuit Court of Kanawha County are merely his agents, and that the only assets really under their independent control are a few hundred thousand dollars in value of free securities, real estate and tangible personal property. I am further impressed by the fact that whereas the total securities deposited in West Virginia are valued in the market at approximately ten million dollars, the total outstanding contracts in West Virginia represent only approximately two million dollars in cash liabilities. If administration of these securities were left in the control of the West Virginia state court or of the State Auditor, an inequitable situation would result. The state court or State Auditor would be vested with power to administer eight million dollars worth of securities deposited in West Virginia to secure cash liabilities in other states where there is no law requiring deposits and where deposits do not equal liabilities, and at the same time would be without power or control over any of the deposits in those other states where deposits have been made and maintained.

There is another reason why the receivership proceeding in the Circuit Court of Kanawha County is not conducive to the best interests of creditors. One of the receivers appointed by that court is an attorney connected with the law

firm of Koontz & Koontz. The firm of Koontz & Koontz represents the receivers, both in the Circuit Court of Kanawha County and in the litigation in this court. Arthur B. Koontz, senior partner in the firm of Koontz & Koontz, was for many years a director of the Debtor, and as such [fol. 333] was closely associated with its affairs and with the other members of its board of directors during this years of service as a director. It is not improbable that investigation into Debtor's affairs may disclose the existence of liability from some or all of the directors to Debtor's creditors. Is it reasonable to suppose that such liabilities, if any, would be diligently sought out and pursued in a proceeding with which one of Debtor's directors is so closely associated? The question answers itself. I have no criticism of the action of the Circuit Court of Kanawha County in appointing the receivers who were appointed. Doubtless that court, not being bound by the prohibitions of Chapter X with reference to appointment of interested persons, acted as seemed best to that court under the pleadings and evidence presented to it. I must decide the questions presented here in the light of all the facts and circumstances in connection with the state court receivership, which circumstances I deem to be of some weight in deciding whether the best interests of creditors would be subserved in the prior proceeding. I am of opinion that they would not be best subserved.

It is further argued that under the general meaning of the term "good faith" the Debtor did not in fact exercise good faith in filing the petition for corporate reorganization. By lack of good faith in proceedings such as this it is ordinarily meant that the petition, if filed by creditors, is filed for the purpose of harassing or embarrassing the Debtor, and if filed by the Debtor, is filed for the purpose of hindering, delaying or defrauding creditors. When subjected to this test, I can perceive no substantial basis for the contention that the petition was not filed in good faith. It was calculated to bring about a result which would not only not hinder, delay or defraud the creditors, but which would benefit them by removing the litigation from numerous state court proceedings, wherein Debtor's assets might reasonably be expected to be largely dissipated in costs, fees, and market losses by forced liquidation, to a forum where, under the broad and salutary provisions of Chapter X of the Bankruptcy Act, its assets may be conserved and

its financial structure reorganized and rehabilitated, if a feasible plan can be devised. The fact that some stockholder or director may have been motivated by the hope [fol. 334] that he might preserve for the future some connection with the affairs of the company is not in itself proof of bad faith. The evidence shows that the directors who participated in the proceedings to authorize the filing of the petition entertained the bona fide belief, at the time they voted in favor of the resolution authorizing the petition to be filed, that it was only by proceeding under Chapter X in a United States Court that Debtor could reasonably hope to obtain any practical results by way of corporate reorganization.

I am satisfied that the petition complies with the requirements of Chapter X of the Bankruptcy Act, and has been filed in good faith.

Does the Eleventh Amendment to the Constitution of the United States limit the power of this court with reference to the securities deposited with the several state depositaries?

It is urged that insofar as the present proceeding requires the court to act with reference to securities deposited with state officials and now in their hands, it is to that extent a suit against the state and therefore within the prohibition of the Eleventh Amendment. It is further contended by Auditor Sims that the receivers appointed by the Circuit Court of Kanawha County are merely his agents and that therefore the same constitutional prohibition applies to a suit against them as he alleges with respect to the suit against him. I may dispose of the latter contention summarily by saying that I know of no principle of law or equity, nor has any such been cited to me, whereby an ordinary equity receiver appointed by a Circuit Court under a general statute can be treated in any other capacity than as an officer of the court appointing him. The fact that a statute of the State of West Virginia requires that before receivers of insolvent insurance (and perhaps, by implication, investment) companies may present their report to the court for confirmation, they must first submit it to the Insurance Commissioner (W. Va. Code, Chapter 33, Article 2, Section 36, Michie's Code of 1937, Section 3317) can have no bearing on the question of the receivers' status in this case. It is always necessary and essential that the court exercise its authority and discretion in acting upon

receivers' reports, whether such reports are approved by the Insurance Commissioner or not.

In deciding the more substantial question of whether or [fol. 335] not this phase of the proceeding should be deemed a suit against the states which hold deposits, I am impressed by the fact that here the state is only a nominal and not a real party in interest. As I have already pointed out in an earlier part of this opinion the assets deposited with the states remain assets of the Debtor and the maximum extent of the interest of the states in those deposits is that they be held in custody until the liabilities of the Debtor are redeemed or settled. Compliance with any decree which may be entered by this court in this proceeding will not require the doing of any affirmative act which affects the states' political or property rights. The result of this litigation will neither inure to the benefit of, nor impose any liability upon any state. The real parties in interest are the Fidelity contract holders and the Debtor itself. It is with respect to the contract holders, (the creditors) that any decree entered by this court will effectively operate. The general governmental interest of a state in the welfare of its citizens in compelling obedience to the orders of its officials and securing compliance with its laws is not such as to make it a party in interest in this litigation. *Morrill v. American Reserve Bond Company*, 151 Fed. 305 (C. C. W. D. Mo. 1907); *Porter v. Beha*, 12 F. (2d) 513 (2 C. C. A. 1926); *Hobbs v. Occidental Life Insurance Company*, 87 F. (2d) 380 (10 C. C. A. 1937).

Is the order of this court with reference to securities in the hands of a state as a depositary violative of the Tenth Amendment to the Constitution of the United States?

It is argued that the state statutes regulating investment companies were enacted under the police power of the states and that insofar as Chapter X of the Bankruptcy Act purports to give to a Federal court the power to enter a decree in conflict with these state laws, it violates the Tenth Amendment and is therefore to that extent inoperative.

It is well settled that Chapter X providing for corporate reorganization is within the bankruptcy power granted to the Federal Government by the Constitution. For a time in recent years the question of whether the Tenth Amendment is a limitation upon the powers of Congress was not clearly answered by the courts; but since the decision in

*U. S. v. Darby Lumber Company*, 312 U. S. 100; 61 S. Ct. 451; 85 L. Ed. 395, there can be no doubt as to the answer. In that case the present Chief Justice said: "Our conclu- [fol. 336] sion is inaffected by the Tenth Amendment • • • . The amendment states but a truism that all is retained that has not been surrendered. There is nothing in the history of its adoption to suggest that it was more than declaratory of the relationship between the national and state governments as it had been established by the Constitution before the amendment or that its purpose was other than to allay fears that the new national government might seek to exercise powers not granted, and that the states might not be able to exercise fully their reserved powers • • •.

"From the beginning and for many years the amendment has been construed as not depriving the national government of authority to resort to all means for the exercise of a granted power which are appropriate and plainly adapted to the permitted end." See the Article "*The Tenth Amendment Retires*," in American Bar Association Journal, April, 1941.

As I have already pointed out, the only respect in which the state statutes can be said to conflict with the Bankruptcy Act is that they give to state officials the right to retain custody of the deposits until final settlement or redemption of Debtor's liabilities. If such provisions are in conflict with Chapter X of the Bankruptcy Act (a question which I do not deem it necessary to decide at this time), *In Re: Bajardi*, 9 F. (2d) 797 (2 C. C. A. 1926), the provisions of the Bankruptcy Act must be held to be "paramount to any state statute the effect of which may impair or emasculate them." (*In Re: Coney Island Hotel Corporation*, 9 F. Supp. 329 (E. D. N. Y. 1934); *Everard's Breweries v. Day*, 265 U. S. 545, 558; *U. S. v. Darby Lumber Co., Supra.*

On the remaining question of whether the deposits made with state officials are "contracts in the public authority," I think it is sufficient to say that in my opinion that phrase as used in Chapter X of the Bankruptcy Act has no application to the circumstances here presented. Moreover, this proceeding need involve no disaffirmance or rejection of any such contracts, if contracts they be. The deposits with the states are held subject to the order of a court of competent jurisdiction. Certainly this court as such will give effect

to whatever contractual rights may exist. It will be time to object if and when this court shall enter any decree which [fols. 337-338] may operate as a rejection of any so called "contracts in the public authority."

The various state officials holding Debtor's deposits, and *a fortiori* the receivers, are not adverse claimants. The argument to the contrary is unsubstantial and without merit. The deposits are held as security for the payment of claims of Debtor's contract holders. Debtor has never been divested by any kind of foreclosure proceedings of its residual interest in the deposits. They are not adversely held. No plenary suit is required in dealing with them. The assertion of adverse claims, being merely assertion and no more, may be disposed of summarily, as I have done. *Gamble v. Daniel*, 89 F. (2d) 447 (8 C. C. A. 1930-; *In Re; Faour, et al.*, 72 F. (2d) 719 (2 C. C. A. 1934); *Hobbs v. Occidental Life Insurance Co., Supra; Continental Illinois National Bank & Trust Company v. Chicago, R. I. & P. R. Co.*, 294 U. S. (1935) 648; *Miles v. New South B. & L. Assn.*, 95 Fed. 919 (C. C. A. D. Ga. 1899).

The conclusion is that the motions for dissolution of the injunction "freezing" the deposits in the hands of state depositaries and for rescinding the orders directing state receivers to turn over to the trustee assets of the Debtor in their hands are overruled and the Debtor's petition for corporate reorganization filed on June 6, 1941, is approved.

An order may be entered in accordance with this opinion.

(Signed) Ben Moore, District Judge.

December 24, 1941.

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[fol. 339] In United States District Court

[Title omitted]

Motion to Amend Findings and Make Additional Findings, and Amend the Judgment Accordingly—Filed January 14, 1942

Comes now Edgar B. Sims, Auditor, etc., of the State of West Virginia, and H. Isaiah Smith and Ross B. Thomas, this 14th day of January, 1942, and within ten days after the entry of judgment in the above case, and in accordance with Rules of Civil Procedure, Rule 52(b), move the Court

that the findings made by it in its written opinion in the above case be amended in the following particulars, and the judgment accordingly amended:

1. On page 4, the Court stated "• • • under the provisions of what is now Article 9 of Chapter 33 of the Code of West Virginia • • •", and it should be "• • • under the provisions of what was Article 9 of Chapter 33 of the Code of West Virginia until that article was abolished by the 1941 session of the Legislature of West Virginia, Chapter 46, Section 12, passed March 8, 1941, in effect ninety days from passage • • •".

2. On page 5, the Court stated "• • • a sufficient portion was to be set aside in a reserve fund which was to produce the sum required to pay • • •" and it should be "• • • a sufficient portion was to be set aside in the reserve fund, which improved at a specified rate of interest at specified intervals, was to produce the sum required to pay • • •".

3. On page 5, the Court also stated "• • • some provided for reserves on a 4½% basis and some on a 4% basis," and it should be "• • • some provided that the reserves be improved on a 4½% basis and some on a 4% basis."

4. On page 6, the Court stated "• • • must deposit with the state treasurer in trust for the benefit of • • •", and it should read "• • • must deposit with the state treasurer (in accordance with Article 5, Chapter 12, of the Code) in trust for the benefit of • • •".

5. On page 12, the Court stated "• • • most of the other states • • • began proceedings looking toward the liquidation of the deposits in those states • • •" and it should be "• • • most of the other states • • • re- [fol. 340] ceived a telegram from Auditor Sims of West Virginia advising them of the action he had taken in Kanawha County, West Virginia, and asking them to institute similar proceedings under their laws, looking toward the freezing of the assets of Fidelity under legal protection until it could be determined by Auditor Sims, in conjunction with the proper state officials of other states, whether reorganization was feasible or whether liquidation would be necessary • • •".

6. On page 14, the Court, in listing the directors present at the meeting of October 3, 1941, lists one *H.* C. Hazlett, whereas it is believed it should be *A.* C. Hazlett.

7. The Court, on page 14, after listing the names of the directors present at the meeting of October 3, 1941, states: "Seven of the directors present at this last meeting were not affected by the provisions of the Investment Company Act of 1940 already referred to." It is submitted that the Court erred in this statement. F. H. Pulfer was an officer and employee at the time of the Detroit injunction; Philip D. Paull was a minor official and employee at that time; John Marshall and John Marshall, Jr.; were both officers and directors at that time; D. A. Burt was a director at that time; Gordon Hoystetter was an employee at that time; F. s. Risley was a director and officer at the time; leaving only Allen G. Messick, James Paull, W. L. Burt, George Miller, H. Julian Ulrich and H. C. Hazlett.

The stock records of Fidelity Assurance Association show that A. C. Hazlett, as well as H. C. Hazlett, did not own any stock, either preferred or common, on either September 17th or October 3rd or October 10th, 1941, and thereby the said A. C. Hazlett, or H. C. Hazlett, never properly qualified as a director, in that he never became a stockholder within one week after his election.

H. Julian Ulrich, a neighbor and very close friend of Philip D. Paull, has transferred to him one share of common stock by Philip D. Paull on October 2, 1941. George H. Miller, who is advised to be a truck driver and an uncle of Harry Hobstetter, an officer and employee of Fidelity and a witness for the debtor, had transferred to him one share of preferred stock by D. A. Burt on October 2, 1941. Gordon E. Hobstetter, a cousin of the said Harry Hobstetter, had [fol. 841] transferred to him one share of preferred stock by D. A. Burt on October 2, 1941. W. L. Burt is the son of D. A. Burt, and had transferred to him ten shares of preferred stock by D. A. Burt on October 2, 1941. James S. Paull is the father of Philip D. Paull and brother-in-law of John Marshall, Sr., and uncle of John Marshall, Jr., his sister having married John Marshall, Sr., and the said James S. Paull is the son of Joseph F. Paull, founder of Fidelity. Philip D. Paull is the son of James S. Paull and nephew of John Marshall, Sr., and cousin of John Marshall, Jr. A. C. Hazlett is the son of the former partner of D. A.

Burt in the brokerage business of Hazlett and Burt, and is, or was, an employee of the brokerage firm of Hazlett and Burt, and was for many years past so employed.

8. On pages 14 and 15, the Court omitted to state that there was a strenuous objection to the stockholders' meeting of October 3, 1941, on the ground that the board of directors had abolished both the common and preferred classes of stock of Fidelity and had substituted therefor a new class of stock for which the old classes of stock could be exchanged, and that no shares of stock present at the meeting of October 3rd were of this new and only class of existing stock, but that all shares of stock there present were only the old shares of stock which had been abolished.

9. In view of the above, the Court's conclusion of law, on page 22 of the opinion, "* * * but I may properly say in passing that the October 3rd meetings were in all respects legal," should be changed to read, "The October 3rd meetings were in all respects illegal and were void and of no effect."

10. On page 15, the Court, in speaking of the authority to employ Allen G. Messick and James R. Fleming to assist the trustee in certain matters, stated that such authority later had been revoked, and it is suggested that the dates of such revocations should be inserted. The Court further stated, "* * * Messick and Fleming were never actually employed by the trustee," and it is submitted that the Court should set forth the facts as shown by the record, wherein Messick and Fleming held themselves out as employed by the trustee to the officials of the State of Wisconsin and to the various officials of the states in which Fidelity did business, who met in Chicago, Illinois, at which meeting Mr. Fleming was present, and should further set forth the evi- [fol. 342] dence concerning Mr. Fleming and Mr. Messick as shown by the record and as stated by Mr. Fleming and Mr. T. C. Townsend in their remarks to the Court.

11. On page 21, the Court, in its conclusions of law, states: "It is an elementary principle of law that one who resigns an office may recall or revoke his resignation at any time before it is accepted." It is submitted that this might be true of one who had occupied the office of a director, but as to one who never occupied the office of director, and Wheeler

Bachman was such a person with regard to Fidelity, until he had accepted the office of director he had no office to resign from, and that his refusal, in writing to qualify as a director did not need action by the board of directors, but became effective when received by the company, and that he could not therefore occupy the office of director without being reelected.

12. On page 22, the Court states: "It follows that the filing of the petition for corporate reorganization, though originally not properly authorized, was afterwards duly ratified," and it is submitted that the conclusion of law by the Court, in view of all of the above, should be, "was afterwards never duly ratified", and therefore the judgment should be amended to the effect that the petition was never properly authorized, and therefore the Court has no jurisdiction.

13. In view of the Court's conclusions of law on the question of whether reorganization can be effected, beginning on page 27 and continuing through page 30, it is submitted that the Court, on the basis of its own findings as therein set forth, should hold, "It is unreasonable to expect that a plan of reorganization can be effected other than a plan for a slow, beneficial and orderly liquidation, and it is unreasonable to expect that there can be any successful rehabilitation of the debtor as a going or continuing corporation."

14. It is submitted that the Court should find that the extravagant sales and promotion expenditures, and expenditures for lavish offices, etc., should from the evidence be held to have been shown to be necessary in order that Fidelity could make the sales which it did make, and in order to employ the salesmen that it did employ.

15. On page 31, the Court states that in its opinion it is absurd to say that a court having jurisdiction only within [fols. 343-346] the State of West Virginia could properly deal with assets located in twenty-nine different states, yet it is submitted that the Court has not taken into account the fact that the United States District Court for the Southern District of West Virginia has no jurisdiction of the persons who possess and control the assets located in the twenty-nine different states otherwise than as they come or be found within the territorial limits of that United States Court.

16. On page 30, the Court finds as a matter of law that the debtor's assets would be peculiarly benefitted in a slow and orderly liquidation, and that the dumping of twenty million dollars worth of securities of the kind held by the debtor upon the market would result in substantial losses, and it is submitted that there is no evidence to sustain that finding. On the contrary, there is evidence to show that every large insurance company in America had millions of dollars in cash in its treasury and was looking for the opportunity to buy good securities of the kind held by the debtor, and it is common knowledge that many times twenty million dollars worth of securities were sold by the British Government in the United States of America on "over the counter" deals, after the market had closed, without substantial losses, and it is submitted that the opinion be corrected in this regard.

It is therefore respectfully moved that the findings of the Court and the judgment be accordingly amended as hereinabove set out.

Respectfully submitted, (S.) Clarence W. Meadows, by J. C. Palmer III. Clarence W. Meadows, Attorney General of West Virginia, Attorney for Edgar B. Sims, Auditor, etc., of the State of West Virginia. (S.) Koontz & Koontz, by J. Campbell Palmer III. Koontz & Koontz, Attorneys for West Virginia State Court Receivers.

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[fol. 347] IN UNITED STATES DISTRICT COURT

[Title omitted]

ORDER OVERRULING MOTION TO AMEND FINDINGS, ETC.—February 25, 1942

This cause came on February 11, 1942, to be heard on the motion of the West Virginia State Court Receivers that a certain letter, dated September 19, 1941, addressed by the Honorable Julian F. Bouchelle, Judge of the Circuit Court of Kanawha County, West Virginia, to the Honorable Ben Moore, Judge of the United States District Court for the Southern District of West Virginia, and the reply of the said Honorable Ben Moore thereto, be made a part of the record in this cause, to which motion the Debtor, by counsel, objected on the ground that the motion was too late, the case

having been heretofore submitted and decided by the Court, and the Securities & Exchange Commission, by counsel, objected, unless the Order show the purposes for which the letters are received, on the ground that they are hearsay evidence of the truth of what the letters contain; and it being represented to the Court by movants that the Honorable Julian F. Bouchelle has no objection to the said letters being incorporated in the record in this cause, and after argument of counsel and full consideration thereof, the Court is of opinion to file said letters among the papers in this cause, only for the limited purpose of showing that said letters were exchanged, unless the Honorable Julian F. Bouchelle [fol. 348] is presented for cross-examination; and the movants having thereupon requested the said Julian F. Bouchelle to present himself for cross-examination, and reported to the Court that the said Honorable Julian F. Bouchelle did not wish to testify in this cause, it is,

Ordered, that the said letters may be filed among the papers of this cause, but only for the limited purpose of showing that such a letter was written to the said Honorable Ben Moore and that he replied thereto, and not as proof of the matters stated in said letters.

And thereupon this cause came on to be heard on the motion of the West Virginia State Court Receivers and the other parties hereto who have filed herein a notice of appeal to the Circuit Court of Appeals that a day be fixed for filing and docketing the record on appeal, and after argument of counsel and full consideration thereof, it is,

Ordered, that the record on appeal shall be filed with the Circuit Court of Appeals on March 12, 1942, except that the original exhibits introduced at the hearings held herein shall be filed with the Circuit Court of Appeals on April 10, 1942; and it is further,

Ordered, that any of the parties hereto may, prior to April 10, 1942, use the said exhibits for a reasonable time in working on the matters connected with said appeal, on giving a proper receipt therefor to the Clerk of this Court. [fol. 349] And thereupon this cause came on to be heard on the motion of the West Virginia State Court Receivers and the other parties hereto who have filed herein a notice of appeal to the Circuit Court of Appeals that the original exhibits introduced in evidence at the hearings held herein be sent to the Circuit Court of Appeals in lieu of copies

thereof, and after argument of counsel and full consideration thereof, it is,

Ordered, that said motion be and the same is hereby sustained, and that the said original exhibits introduced in evidence at the hearings held herein be sent to the Circuit Court of Appeals in lieu of copies thereof; and it is further,

*Ordered*, that the Clerk of this Court do personally deliver the said original papers and exhibits to the Clerk of the Circuit Court of Appeals at Richmond, Virginia, or do send them to the said Clerk of the Circuit Court of Appeals by a competent messenger selected by the Clerk of this Court; and it is further,

Ordered, that the said original papers and exhibits be returned to the Clerk of this Court when the Circuit Court of Appeals shall have finished with them, and that the Clerk of this Court be and he is hereby authorized to take such steps as he may deem proper for their safe return to his office.

And thereupon this cause came on to be heard upon the motion of the Debtor that the West Virginia State Court Receivers and the other parties to this cause who have filed notice of appeal to the Circuit Court of Appeals be required to notify the Debtor and other appellees as to what part of the record they propose to print as an appendix to their briefs, respectively, not later than March 22, 1942, and after argument of counsel thereon and full consideration thereof, there being no objection thereto, it is,

[fol. 350] Ordered, that the said motion be sustained, and that the appellants notify the appellees what part of the record each of said appellants proposes to print as an appendix or supplement to the brief of each said appellant, not later than March 22, 1942.

And thereupon the West Virginia State Court Receivers tendered to the Court and asked leave to file their motion, in writing, that the Court hold a hearing and enter an order adjudicating the Debtor a bankrupt, or dismiss this proceeding; that the Court fix a time, not later than March 13, 1942, within which the Trustee shall comply with Section 167 (1) of the Bankruptcy Act, particularly with

respect to the continuance of the operation of the Debtor's business; that the Trustee file immediately the report prescribed by Section 167 (5) of the Bankruptcy Act; that the Court fix a time, not later than March 13, 1942, within which the Trustee shall file the report required by Section 169 of the Bankruptcy Act; that the Court fix the division of creditors and stockholders into classes in pursuance of Section 197 of the Bankruptcy Act; that a hearing be held to determine similarly the value of the securities held by secured creditors, and to classify as unsecured the amount of their said claims in excess thereof; and that the time for filing claims under Section 196 of the Bankruptcy Act be not fixed until the classification of creditors is determined, and the said motion was Ordered filed. Thereupon this cause came on to be heard on the said motion of the West Virginia State Court Receivers, and after argument of counsel and full consideration thereof, it is,

Ordered, that the said motions be overruled; and it is further,

[fol. 351] Ordered, that said motions of the West Virginia State Court Receivers be dismissed as improvidently filed.

And thereupon this cause came on again to be heard on the motion of L. H. Brooks, Trustee, Frederic Leake, and A. L. Goldberg, Jr., Trustee, that Central Trust Company, Trustee, forthwith make and file a report, as provided for in Section 167 of the Bankruptcy Act, as to the desirability of the formulation of a plan of liquidation in accordance with their suggestions, and after argument of counsel and full consideration thereof, it is,

Ordered, that said motion be and the same is hereby overruled.

And thereupon this cause came on again to be heard on the motion of L. H. Brooks, Trustee, Frederic Leake, and A. L. Goldberg, Jr., Trustee, that Central Trust Company, Trustee, forthwith make and file a report in accordance with Section 167 of the Bankruptcy Act as to the desirability of the continuance of the Debtor's business, and after argument of counsel and full consideration thereof, it is,

Ordered, that said motion be and the same is hereby overruled.

And it appearing to the Court that Central Trust Company, Trustee, has assembled additional information relating to the matters mentioned in Section 167 of the Bankruptcy Act, it is,

Ordered, that Central Trust Company, Trustee, prepare and file within sixty days from this date a further report thereon.

[fol. 352] And thereupon this cause came on again to be heard on the motion of L. H. Brooks, Trustee, Frederic Leake, and A. L. Goldberg, Jr., Trustee, that the Court enter an Order fixing, in accordance with Section 197 of the Bankruptcy Act, the division of creditors into classes according to the nature of their respective claims, and set an early date for a hearing for such purpose, and that the Court fix a time within which Central Trust Company, Trustee, shall prepare and file a plan or a report of its reasons why a plan cannot be effected, and also a subsequent time for a hearing on such plan or report in accordance with Section 169 of the Bankruptcy Act, and that the Court advance the time of such hearings in accordance with Section 171 of the Bankruptcy Act, and after argument of counsel and full consideration thereof, it is,

Ordered, that said motion be and the same is hereby overruled.

And thereupon this cause came on again to be heard on the motion of L. H. Brooks, Trustee, Frederic Leake, and A. L. Goldberg, Jr., Trustee, that the Court enter an Order restraining the Trustee from sending out any notices to policy holders to file claims in this proceeding until there has been a division of creditors into classes and an Order of the Court fixing a time for filing of claims, and that no Order be made with regard to the filing of claims of creditors until a hearing has been held on certain motions theretofore filed, and after argument of counsel and full consideration thereof, it is,

Ordered, that said motion be and the same is hereby overruled.

[fols. 353-396] And thereupon this cause came on again to be heard on the motion of Edgar B. Sims, Auditor etc., and of the West Virginia State Court Receivers, that the findings made by the Court in its written opinion filed herein

be amended in certain particulars, and that the judgment of the Court be amended accordingly, and after argument of counsel and full consideration thereof, it is,

Ordered, that said motion be and the same is hereby overruled, except that any typographical errors shall be corrected, and that the correction requested in section one of said motion will be made.

And thereupon the Debtor, by counsel, moved that all the statements of facts contained in the said motion of Edgar B. Sims, Auditor etc., and of the West Virginia State Court Receivers, which are not based on testimony introduced at the hearings held herein before the case was submitted, be expunged from the record in this proceeding, and after argument of counsel and full consideration thereof, it is,

Ordered, that said motion be and the same is hereby sustained, and the said statements of facts are hereby expunged from the record in this proceeding.

And thereupon Edgar B. Sims, Auditor etc., and the West Virginia State Court Receivers, by counsel, moved that the hearings in this cause be re-opened for the introduction of additional testimony, and after argument of counsel and full consideration thereof, it is,

Ordered, that the said motion be and the same is hereby overruled.

Enter: Ben Moore, United States District Judge.

February 25, 1942.

(S.) O. K. for Appellants by J. C. Palmer III.

* * * * * * *

[fol. 397] IN UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT

No. 4923

EDGAR B. SIMS, Auditor of the State of West Virginia, and Ex-Officio Insurance Commissioner of the State of West Virginia; Ross B. Thomas and H. Isaiah Smith, West Virginia State Court Receivers; Banking Commission of Wisconsin; Chas. R. Fischer, Commissioner of Insurance and Permanent Receiver for Debtor Corporation in and for the State of Iowa; John B. Gontrum, Insurance Commissioner of the State of Maryland; Dewey S. Godfrey, Missouri State Court Receiver; and L. H. Brooks, Trustee, Frederic Leake and A. L. Goldberg, Jr., Trustee, Appellants,

versus

FIDELITY ASSURANCE ASSOCIATION, a Corporation, Debtor, Appellee

Appeal from the District Court of the United States for the Southern District of West Virginia, at Charleston. In Bankruptcy

March 12, 1942, the transcript of record is filed and the cause docketed.

Same day, joint motion of the parties to advance the case for argument is filed in open court before Parker, Soper and Dobie, Circuit Judges, and submitted.

ORDER ASSIGNING CASE FOR ARGUMENT, ETC.—Filed and Entered March 12, 1942

On Consideration of the Joint Motion of the parties in this cause, by their respective counsel, and for good cause shown,

It Is Ordered by this Court that the above case be, and the same is hereby assigned for argument at the April Term of this Court at Richmond, Va., on Monday April 20, 1942.

It Is Further Ordered that the briefs on behalf of the appellants be filed not later than Tuesday March 24, 1942; [fol. 398] that the briefs for the Debtor and any briefs submitted on behalf of the Securities and Exchange Com-

mission or on behalf of the Trustee be filed not later than Saturday April 11, 1942; and any reply briefs submitted on behalf of any of the appellants be filed not later than Friday April 17, 1942.

March 12, 1942.

John J. Parker, Senior Circuit Judge.

March 14, 1942, the appearance of Guy B. Brown and H. Vernon Eney is entered for the appellant John B. Gontrum, Insurance Commissioner of the State of Maryland.

Same day, the appearance of J. Campbell Palmer, III, is entered for the appellants Edgar B. Sims, Auditor, etc., Ross B. Thomas and H. Isaiah Smith, West Virginia State Court Receivers.

March 16, 1942, the appearance of John V. Ray is entered for the appellee, and the appearance of T. C. Townsend and Hillis Townsend is entered for the appellee (Trustee).

Same day, the appearance of Rudolph K. Schurr is entered for the appellant Dewey S. Godfrey, Missouri State Court Receiver.

Same day, petition of Banking Commission of Wisconsin, Charles R. Fischer, Insurance Commissioner of the State of Iowa, Edgar B. Sims, Auditor and Ex-Officio Insurance Commissioner of the State of West Virginia, and Ross B. Thomas and H. Isaiah Smith, West Virginia State Court Receivers, for leave to file joint brief not exceeding 100 pages, etc., is filed.

March 17, 1942, the appearance of Clarence W. Meadows, Attorney General of West Virginia, is entered for the appellant Edgar B. Sims, Auditor, etc.

March 19, 1942, the appearance of Fyke Farmer is entered for the appellants L. H. Brooks, Trustee, Frederic [fol. 399] Leake and A. L. Goldberg, Jr., Trustee.

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In United States Circuit Court of Appeals

Order as to Length of Briefs, etc.—Filed March 20 1942

Upon the Application of Edgar B. Sims, Auditor, etc.; H. Isaiah Smith and Ross B. Thomas, West Virginia State Court Receivers; Banking Commission of Wisconsin, and

Charles R. Fischer, Commissioner, etc., appellants, by their respective counsel, and for good cause shown,

Leave Is Hereby Granted Edgar B. Sims, Auditor of the State of West Virginia, and Ex-Officio Insurance Commissioner of the State of West Virginia; and Ross B. Thomas and H. Isaiah Smith, West Virginia State Court Receivers, appellants in the above-entitled case, to file a joint brief in their behalf not exceeding 100 printed pages in length; and the Banking Commission of Wisconsin and Charles R. Fischer, Commissioner of Insurance and Permanent Receiver for debtor corporation in and for the State of Iowa, appellants, to file a joint brief in their behalf not exceeding 100 printed pages in length; and

Leave Is Also Granted the appellants to print a joint statement of facts, not to exceed 60 printed pages in length, which shall be printed only in the brief filed on behalf of the joint West Virginia appellants; and shall not be counted within the limited number of pages of the joint brief to be filed on behalf of the West Virginia appellants.

March 19, 1942.

John J. Parker, Senior Circuit Judge.

March 23, 1942, the appearance of Richard H. Lauritzen, Assistant Attorney General, State of Wisconsin, is entered for the Appellants Banking Commission of Wisconsin and Chas. R. Fischer, Commissioner of Insurance, etc. [fol. 400] Same day, the appearance of Carl J. Stephens and Ben C. Buckingham is entered for the appellant Chas. R. Fischer, Commissioner of Insurance and Permanent Receiver for the debtor corporation for the State of Iowa.

Same day, brief and appendix on behalf of the appellants Banking Commission of Wisconsin, et al., are filed.

Same day, brief on behalf of the appellant Dewey S. Godfrey, Missouri State Court Receiver, is filed.

March 24, 1942, joint brief and appendix on behalf of the West Virginia appellants are filed.

Same day, brief and appendix on behalf of appellant John B. Gontrum, Insurance Commissioner of the State of Maryland, are filed.

Same day, brief and appendix on behalf of appellants L. H. Brooks, Trustee, et al., are filed.

April 3, 1942, the appearance of James R. Fleming is entered for the appellee.

April 10, 1942, the original exhibits are certified up.

Same day, brief and appendix on behalf of the appellee are filed.

Same day, brief on behalf of Central Trust Company, Trustee, is filed.

April 11, 1942, brief on behalf of Securities and Exchange Commission is filed

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IN UNITED STATES CIRCUIT COURT OF APPEALS

ORDER GRANTING SECURITIES AND EXCHANGE COMMISSION LEAVE TO FILE BRIEF EXCEEDING FIFTY PRINTED PAGES—Filed April 13, 1942

Upon The Application of counsel for the Securities and Exchange Commission, and for good cause shown,

Leave is hereby granted the Securities and Exchange [fol. 401] Commission to file a brief exceeding 50 printed pages but not in excess of 100 printed pages.

April 10, 1942.

John J. Parker, Senior Circuit Judge.

April 13, 1942, motion of Dorr E. Warner for leave to file brief as *amicus curiae* filed in open Court before Parker, Soper and Dobie, Circuit Judges, and submitted.

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IN UNITED STATES CIRCUIT COURT OF APPEALS

ORDER GRANTING LEAVE TO DORR E. WARNER TO FILE BRIEF AS AMICUS CURIAE—Filed and Entered April 13, 1942

Upon The Application of Dorr E. Warner, Esq., Attorney for Contract Holders of the debtor, and for good cause shown,

Leave is hereby granted him to file twenty-five copies of a printed brief as amicus curiae in the above entitled case.

April 13, 1942.

John J. Parker, Senior Circuit Judge.

April 13, 1942, brief on behalf of Dorr E. Warner as *amicus curiae* is filed.

April 16, 1942, reply brief on behalf of appellant Banking Commission of Wisconsin is filed.

April 17, 1942, reply brief on behalf of appellant John B. Gontrum, etc., is filed.

Same day, reply brief on behalf of West Virginia appellants is filed.

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[fol. 402] In United States Circuit Court of Appeals for the Fourth Circuit

[Title omitted]

Petition to Remand Case to District Court for a Rehearing therein on the Ground of Newly Discovered Evidence—Filed April 18, 1942

Comes now Edgar B. Sims, Auditor and ex officio Insurance Commissioner of the State of West Virginia, appellant in the above case, by counsel, and moves this Honorable Court that the case be remanded to the District Court for a rehearing therein on the ground of newly discovered evidence.

[fol. 403] Background of the Newly Discovered Evidence

On page 41 of the brief filed by the Wisconsin and Iowa appellants, there is set forth parts of the minutes of the Board of Directors' meeting of December 31, 1940, being Exhibit 100, page 156 of the board of Directors' Minutes, wherein it is shown that the company was advised that its amendment to its charter to change its name and to do an insurance business had been granted, and its license as such had been issued.

Thereafter, as shown by the minutes (pp. 156-7), the following took place:

"Authority to Issue Insurance on Income Reserve Contracts, Series B

"Upon motion by Mr. Reed, seconded by Mr. John Marshall, Jr., the following resolution was unanimously passed:

"Whereas, the Fidelity Investment Association has amended its charter and has for its purposes the issuing of insurance upon the lives of persons and the granting and disposing of annu-ties, and has changed its name to Fidelity Assurance Association, and

"Whereas, it is qualified and admitted to transact such business, now, therefore,

"Be It Resolved, That the Association assume, and it does hereby assume and agree to fulfill and pay all the risks and obligations of the insurance policy and the insurance company mentioned in Section 6 of all Income Reserve Series B Contracts now insured by the Lincoln National Life Insurance Company, and

"Be It Further Resolved, That the rider submitted herewith be sent, in duplicate, to each owner of such Income [fol. 404] Reserve Series B Contracts, and that such rider become and be a part of the Income Reserve Series B Contract to which each such rider shall apply, and that an accompanying explanatory letter be sent by the company to each contract owner with such rider, asking each such contract owner to sign such rider, in duplicate, and attach the original to his contract and return the duplicate to the Association.

Approval of Rider and Letter

"An insurance rider and letter of explanation to be sent all Income Reserve Series B Contract holders with insurance protection were submitted to the Board, and upon motion, duly made and seconded, President Risley was requested to send out the following rider and letter to such contract holders."

The letter is set forth both at page 156 of the Minutes and at page 41 of the Wisconsin and Iowa brief, and the rider is set out at page 157 of the Minutes, as follows:

"December 31, 1940.

"Dear Contract-owner:

"It is with pleasure and confidence that we direct your attention to the change in our name and the widening of the scope of our business to that of issuing insurance on the lives of persons. In the future, the company will be known as Fidelity Assurance Association and will offer a complete line of life insurance policies of all types and classes, including life annuities.

"These changes enable us, as a qualified legal reserve life insurance company to assume the risks and obligations provided in Section 6 of your contract. As you know, this Section makes available to you insurance covering all

[fol. 405] monthly payments not yet made in event of your death. Such insurance protection has, in the past, been procured from a legal reserve life insurance company, but was subject to cancellation, upon due notice, at any time. With the making of your regular monthly payments and the Association assuming the insurance, this condition has been eliminated.

"By resolution of the Board of Directors and by the rider enclosed in duplicate, the Association assumes and itself agrees to fulfill and pay the risk and obligations of the insurance policy and of the insurance company mentioned in Section 6 of your contract. The original of the rider is to be signed and attached to your Income Reserve Contract, Series B and the other (the blue one) signed and returned to the Association in the enclosed envelope."

"Fidelity Assurance Association

"Assumption of risk and rider attached to and a part of Income Reserve Contract Series "B" Number

"The Association, having so amended its charter as to authorize it to issue insurance upon the lives of persons and every insurance appertaining thereto and to grant and dispose of annuities, and to change its name to Fidelity Assurance Association, in consideration of the monthly payments, provided for in the above numbered contract hereby assumes and does itself hereby agree to fulfill and pay all the risks and obligations of the insurance policy and the insurance company mentioned in Section 6 of said contract.

"It is hereby agreed between the Association and the contract holder that this insurance agreement shall become and be a part of said contract and the original shall be attached thereto.

[fol. 406] "Executed in duplicate at Wheeling, West Virginia this 31st day of December, 1940.

"Fidelity Assurance Association, (s.) F. s. Risley, President.

——— ———, Contract Owner."

All of the above was in evidence during the hearing of the case, together with the statements of many officers of the Debtor to the effect that no insurance contracts were ever entered into, or insurance been engaged in, after January 1, 1941.

## The Newly Discovered Evidence

Within the last ten days counsel has been advised that on December 31, 1940, not only was the letter of explanation sent out to each Series B Contract holder, together with the two enclosed riders, but that thereafter, during the year 1941, *approximately one-half of all Series B Contract holders with insurance executed one of the riders and returned it to the company,* where they are now and have been on file. Counsel are further advised by the Banking Commission of Wisconsin that they have in their possession many contracts on which the other duplicate rider has been physically attached to the Fidelity contract.

## Effect of the Newly Discovered Evidence

The District Court's opinion on the question of insurance was made without knowledge of this evidence, and was based to a large extent upon the fact that after January 1, 1941, Fidelity never engaged in any insurance business. Counsel for the Debtor in the reply brief persistently asserts that Debtor never did any insurance business after January 1, 1941.

[fol. 407] Counsel contents that the mailing of these letters to the contract holders, after the passage of the resolutions of the Board of Directors, and acceptance by the contract holders by signing the rider and returning it to the company, and physically attaching the duplicate to their contracts, constituted a binding contract of insurance between the Debtor and those executing contract holders. It is further contended that Fidelity therefore engaged in the insurance business in 1941, by agreeing to insure the B Contract holders itself, which as between it and the contract holders was a valid and binding contract, since at that time its amended charter was in effect, its name had been legally changed, and it had a license to do an insurance business. (See Exhibit 24, R. 497, 500.)

As the question of whether Fidelity was an insurance company at the time the Debtor's petition was filed is one of the main jurisdictional questions to be decided by this Court, it is respectfully submitted that this evidence is and should be considered.

Question of Due Diligence

The attorney for the Debtor and attorneys for the Trustee were immediately advised thereof, in order to ascertain the correctness of the facts, who, after investigation, confirmed their correctness. As well those attorneys advised that the Banking Commission of Wisconsin had had correspondence with the Debtor concerning this letter and these riders, which was found to be correct upon investigation; that the State of Virginia had insisted that the Debtor was doing business in the State of Virginia without authority so to do, by virtue of said letter and riders; that a conference was held with Fidelity officials concerning same, which upon investigation, was found to be correct.

[fol. 408] It was further found, upon investigation, that the officers of Fidelity contended to both Wisconsin and Virginia that these acts were not acts of doing an insurance business, as is shown by copies of letters attached hereto, and is undoubtedly the reason that those officers testified in these proceedings that no insurance business had ever been done.

Counsel is advised that Mr. H. Isaiah Smith, the principal officer of the Trustee in charge of Fidelity's work, as late as February 11, 1942, advised Mr. Rickard H. Lauritzen, Assistant Attorney General of Wisconsin, upon being specifically questioned concerning the resolutions of December 31, 1940, and the letter and riders, that to the best of his knowledge and remembrance nothing was done concerning said resolutions and letters, and did not disclose, if he then knew it, that the riders had been executed and returned to Fidelity.

The Auditor of the State of West Virginia, whose affidavit is attached hereto, and Mr. Harlan Justice, his deputy, both were ignorant of the fact that any replies had been received to said letter and riders, although they were advised prior to trial that the letters had been sent out, but upon being informed by Debtor's officers that no acts of insurance were engaged in by the Debtor between January 1st and June 6th, 1941, they made no further investigation of the matter.

Counsel is further advised by counsel for the Trustee and the Trustee's employees that there was no change in the relationship at any time between Fidelity and Lincoln

Life Insurance Company, and that while Fidelity continued to receive the premiums for the B Series Contracts, which included the premiums for insurance, it transmitted the insurance premiums to Lincoln Life Insurance Company, and that it did not on its books ever set up any life insurance company accounts, nor make any arrangements [fol. 409] or provisions for carrying into effect its contract and agreement to insure the B Contract Series, other than as is hereinafter set out.

However, the record in this proceeding shows that in Exhibit 100, pages 157-8 of the Minutes of the Board of Directors' Meetings, the Debtor was authorized to offer to all present contract holders a new *policy* in exchange for their present contract, and a committee was selected to work out the policy; a committee was selected to work on re-insuring policies with a legal reserve life insurance company, and the Board of Directors passed a resolution to re-insure all risks on individuals for amounts over $2500.00 with a legal reserve life insurance company; a resolution was passed for the purpose of meeting requirements of various insurance departments, to have the fiscal year of the Debtor run the same as the calendar year, instead of ending October 31st.

These are all of the facts pertinent to and surrounding the newly discovered evidence, and it is respectfully moved that this Court, under the rule of *Isgrid* v. *U. S.*, 109 F. (2d) 131, consider whether there has been due diligence by the movants, and whether the evidence is of such pertinency as to cause this Court to consider remanding the case to the lower Court.

Respectfully submitted.

Clarence W. Meadows, Attorney General of West Virginia, Ira J. Partlow, Assistant Attorney General of West Virginia, Attorneys for Edgar B. Sims, Auditor, etc., of the State of West Virginia.

[fol. 410] January 15, 1941.

Honorable George A. Bowles, Commissioner of Insurance, Richmond, Virginia.

Dear Sir:

Acknowledgment is made of your wire of January 13 in reference to the assumption by Fidelity Assurance As-

sociation of insurance risks provided in Section 6 of our Income Reserve Series "B" Contracts.

The letter to which you refer in your telegram was mailed from Wheeling, West Virginia to all contract-owners on December 31, 1940 for the purpose of extending to them the privilege of transferring the insurance or self-completion risk, as provided in Section 6 of the contract, to the Fidelity Assurance Association. Such assumption of this risk by Fidelity was dependent upon the decision of the individual contractowners who had the right to either approve or reject such proposal.

The letter was in no way considered by this Association as a means of soliciting insurance, but was a statement in reference to the insurance as provided in Section 6 of the contract. In view of the fact that there was no solicitation, it is not believed that the letter was in violation of any law or statute of any State.

As explained by telephone, this Association is not soliciting insurance either by mail or personal solicitation and will not until licenses have been granted to the company and its agents.

We trust that this letter satisfactorily explains the situation.

Very truly yours,
F. J. McNulty, Vice President and Secretary.

FJMcN/CMH

[fol. 411] Commonwealth of Virginia, State Corporation Commission, Bureau of Insurance

Geo. A. Bowles, Commissioner of Insurance
Richmond

Seal. C. B. Coulbourn, Actuary; T. T. Moore, Chief Examiner; Geo. A. Peery, Statistician; James M. Hayes, Jr., Director of Fire Marshals; Zelle G. Knight, License Clerk; Courteney W. Harris, Fire Rate Clerk.

January 23, 1941.

Fidelity Assurance Association, Wheeling, West Virginia.
Attention: Mr. F. J. McNulty.

GENTLEMEN:

We have received your letter of January 15th in reply to our wire of January 13th.

We have again reviewed this matter and are still of the opinion that your letter of December 31st, addressed to your various contract holders, was a solicitation of insurance in Virginia. Since your association was not licensed as an insurance company, this would appear to be a clear violation of the law. We understood from previous correspondence and from other information that your association expected to apply for a license as in an insurance company in this State, but we have as yet received no further information.

We shall appreciate it if you will let us know when we may expect to receive your application.

Very truly yours,

(signed) Geo. A. Bowles, per M., Commissioner of Insurance.

TTM:J

March 27, 1941.

[fol. 412] Securities Division, State Corporation Commission, Commonwealth of Virginia, Richmond, Virginia.

GENTLEMEN:

Attention: Mr. Blake T. Newton, Jr., Director.

This will acknowledge receipt of your letter of March 25th. We have not ignored the objections raised by representatives of the Commission at the conference held in Charleston, but it seemed useless to pursue the question further at this time.

After we sent out our original notice to contract holders with respect to insurance, the plan then adopted was, as far as the Association was concerned, modified so that the entire risk is still being carried by The Lincoln National Life Insurance Company. The Association does not as yet have any insurance risks outstanding, not fully covered, and the general fund is not subject to the hazards mentioned in your letter.

The plan which will ultimately be followed has not yet been completed, and the suggestion that we organize a new corporation to write the proposed insurance is among the things under consideration. Changing the business over to writing insurance has involved a multiplicity of details. Officials of the Association, with the help of actuaries and auditors, have been studying the matter and are still working on it. Before any insurance is sold and

as soon as our plan begins to take on a definite shape, we will consult with you.

We hope your Division can stand by for a short time. Please advise.

Very truly yours,
F. s. Risley, President.

FsR:VLM

[fol. 413] Copy

Allen G. Pflugradt

January 10, 1941.

Fidelity Assurance Association, Wheeling, West Virginia.

GENTLEMEN:

We have your several communications in connection with your desire to discontinue the sale of your contracts in this state from January 1, 1941, forward.

There are several matters we desire more information on and have, through our Attorney General's office, contacted, your local attorney, Mr. Rieser, who has promised to obtain some additional information for us. We particularly want more light on the solicitation you are engaging in with Wisconsin holders of your contracts to change the insurance protection under Section 6 of your Series B income reserve contracts.

We cannot understand that it is in the best interests of Wisconsin holders to transfer their insurance protection from a company licensed to do business in Wisconsin to a company not licensed to do business in Wisconsin.

Inasmuch as it is your intention not to make any further sales of contracts in Wisconsin, we would appreciate receiving a schedule of all contracts held by Wisconsin holders, the names, addresses, matured value and present cash surrender value of such contracts. We think it would be cheaper for you to prepare this schedule, properly certified, than it would be for us to send an examiner to your office to obtain it.

We expect to have a conference with Mr. Reiser the latter part of next week and by that time we should have

[fol. 414] an answer to this letter, whereupon you will probably hear from us further.

Yours very truly,

Banking Commission of Wisconsin, By ——, Chairman.

AGP:JC

Copy

Organized 1911

Fidelity Assurance Association, Wheeling, West Virginia
Offices in Principal Cities

Received, Jan. 16, 1941. State Banking Dept.

January 15, 1941

Banking Commission of Wisconsin, One West Wilson Street, Madison, Wisconsin.

Attention: Hon. Allen G. Pflugradt.

Dear Sir:

Acknowledgment is made of your letter of January 10 in reference to the assumption by Fidelity Assurance Association of insurance risks provided in Section 6 of our Income Reserve Series "B" Contract.

On December 31, 1940 a letter was mailed from Wheeling, West Virginia to all contractowners for the purpose of extending to them the privilege of transferring the insurance or self-completion risk, as provided in Section 6 of the contract, to the Fidelity Assurance Association. Such assumption of this risk by Fidelity was dependent [fol. 415] upon the decision of the individual contractowners who had the right to either approve or reject such proposal.

The letter was in no way considered by this Association as a means of soliciting insurance, but was a statement in reference to the insurance as provided in Section 6 of the contract. This Association is not soliciting insurance either by mail or personal solicitation and will not until licenses have been granted to the company and its agents.

In reference to your request that we prepare a schedule of all contracts held by Wisconsin residents giving names,

addresses, face amount and cash liability of such contracts, such schedule will be prepared if agreeable to you, as of January 31, 1941. We are suggesting January 31 rather than December 31, 1940 since the compilation of the information at December 31 would involve the reconstruction of our current records and would involve individual handling and sorting of thousands of accounts. All possible haste will be used and we sincerely trust that the date as suggested by us will be entirely agreeable to the Commission.

We hope that this letter will satisfactorily serve your purpose.

Very truly yours,

F. J. McNulty (s), F. J. McNulty, Vice President and Secretary.

FJMcN/CMH

[fol. 416] Affidavit of Edgar B. Sims in Support of Motion to Remand Case on the Ground of Newly Discovered Evidence

Edgar B. Sims states that he is the regularly selected and duly qualified Auditor of the State of West Virginia and ex officio Insurance Commissioner; that he is familiar, as such officer, with the affairs of Fidelity Assurance Association; that on December 31, 1940, he issued a life insurance license to said company for the purpose of enabling them to receive payments on their outstanding contracts, but told the company officials not to sell any insurance; that he so testified in the proceedings (R. 500); that there was an understanding, or gentleman's agreement that the company would abide by these instructions, until he gave further permission to them; that until the proceedings were instituted in the Circuit Court of Kanawha County, West Virginia, he had understood that that agreement had been complied with. Thereafter, he was informed of certain resolutions passed by the Board of Directors of Fidelity on December 31, 1940, but was assured that no act of insurance had been performed thereunder; and he was not advised and remained ignorant of the fact that contract holders executed riders, which had been sent to them, and returned them to the company, until he was advised thereof by his counsel within the last several days; that he attended most of the hearings had before the United States District Court,

in Charleston, West Virginia, and heard various officers of the Debtor testify that the company had engaged in no insurance business under the license issued by him; that for that reason, and for the reason that the minutes of December 31, 1940, were introduced in evidence, he made no further investigation concerning the matter; that he relied upon the statements made by the Debtor's officers and felt no occasion to make further investigation, and nothing was [fol. 417] called to his attention, as he now remembers it, whereby he should have known of the receipt by the Debtor of the executed riders; and he says that according to his best belief and recollection he did not know of said receipt by the Debtor of said riders, nor did his counsel know thereof, until they were so advised by the attorneys representing the Wisconsin and Iowa appellants; that the facts set forth in the "Motion to Remand" are correct according to his best belief and knowledge.

Edgar B. Sims, Affiant.

STATE OF WEST VIRGINIA,
County of Kanawha, To-wit:

Before the undersigned Notary Public, this day came Edgar B. Sims, who, being first duly sworn, says that the facts and allegations set forth hereinabove are true, according to the best of his belief and recollection, except in so far as they are therein stated to be upon information, and that so far as they are therein stated to be upon information, he believes them to be true.

Taken, subscribed and sworn to before me this 15th day of April, 1942.

My notarial commission expires on the 3rd day of November, 1947.

Harry C. Deisher, Notary Public, Kanawha County, West Virginia. (Seal.)

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[fol. 418] IN UNITED STATES CIRCUIT COURT OF APPEALS
NOTICE OF MOTION TO REMAND, ETC.—Filed April 18, 1942

Honorable John V. Ray, Attorney at Law, Charleston, West Virginia.

Messrs. Townsend and Townsend, Attorneys at Law, Kanawha Valley Building, Charleston, West Virginia.

Honorable Justin N. Reinhardt, Attorney, Securities Exchange Commission, 18th and Locust Streets, Philadelphia, Pennsylvania.

GENTLEMEN:

Please take notice that on the 20 day of April, 1942, before the United States Circuit Court of Appeals for the Fourth Circuit, at Richmond, Virginia, at 10:00 A. M., of that day, or as soon thereafter as it might be heard, Edgar B. Sims, Auditor and Ex Officio Insurance Commissioner of the State of West Virginia, by the undersigned, will move said Court that the case of Edgar B. Sims, et al. v. Fidelity Assurance Association, Number 4923, be remanded to the District Court for further proceedings therein, on the ground of newly discovered evidence. A copy of said motion and the affidavit of said Auditor is herewith inclosed.

Clarence W. Meadows, Attorney General of the State of West Virginia.

Charleston, West Virginia, April 15, 1942.

April 18, 1942, reply brief on behalf of L. H. Brooks, Trustee, et al., appellants, is filed.

April 20, 1942, appearance of Dorr E. Warner is entered on behalf of Contract Holders Victor Salkeld, et al.

[fol. 419] Same day, the appearance of Justin N. Reinhardt and Homer Kripke is entered for the Securities and Exchange Commission.

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IN UNITED STATES CIRCUIT COURT OF APPEALS

MOTION OF WEST VIRGINIA APPELLANTS TO STRIKE BRIEF OF CENTRAL TRUST COMPANY, TRUSTEE—Filed April 20, 1942

The West Virginia appellants challenge the right of the Trustee and its attorneys to appear on behalf of the Debtor, and their right to sustain Debtor's petition, and the jurisdiction of the District Court, and move to strike their brief from these proceedings. *Loomis* v. *Gila County*, 103 F. (2d) 312 (certiorari denied, 307 U. S. 643, 83 Law. Ed. 1524) (1939).

Clarence W. Meadows, Attorney General of West Virginia; Ira J. Partlow, Assistant Attorney General; J. Campbell Palmer, III, Of Koontz & Koontz, Counsel for West Virginia, Appellants.

IN UNITED STATES CIRCUIT COURT OF APPEALS

AFFIDAVIT IN OPPOSITION TO MOTION TO REMAND CASE—Filed April 20, 1942

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STATE OF WEST VIRGINIA,
County of Ohio, ss:

Before the undersigned authority, a Notary Public in and for the County and State aforesaid, this day personally appeared F. J. McNulty, who being by me first duly sworn deposes and says as follows:

That in the early part of 1941 he was Vice-President and Secretary of Fidelity Assurance Association, of Wheeling, West Virginia; that as a part of the preparations which Fidelity Assurance Association made for the purpose of engaging in the insurance business it mailed to certain of its contract holders, on December 31, 1940, a letter relating to [fol. 420] the insurance provided for in Section 6 of certain of its contracts; that the said letter and the so-called "rider" which accompanied it were not intended as a solicitation of insurance by Fidelity Assurance Association, because it was not on that date authorized to engage in the insurance business; that Fidelity Assurance Association was never authorized to engage in the insurance business by the officials of the State of West Virginia in charge of the administration of the statutes of West Virginia relating to insurance, and Fidelity Assurance Association never at any time assumed the risk referred to in said letter and said rider; that after the said letter of December 31, 1940 was mailed, Fidelity Assurance Association received inquiries from the officials of various states, and in reply to said inquiries wrote letters, of which true copies are attached hereto as a part hereof; that the insurance risk provided for in Section 6 of certain contracts issued by Fidelity Assurance Association were never assumed by Fidelity Assurance Association, but were at all times after December 31, 1940 insured by the Lincoln National Life Insurance Company or Columbian National Life Insurance Company, as the same had been insured prior to December 31, 1940; that Fidelity Assurance Association never accepted any

money as a premium on any insurance risk; that Fidelity Assurance Association never at any time insured any risk, and never at any time issued any insurance policy; that no changes were made on the books and records of Fidelity Assurance Association of the character which would have been necessary had it engaged in the insurance business, that the books of Fidelity Assurance Association show that it has never received any premium income, has never set up any reserves, nor provided for the surplus as required to engage in the insurance business in West Virginia.

[fol. 421] Affiant further says that the Lincoln National Life Insurance Company issued to every holder of a contract issued by Fidelity Assurance Association, for which insurance was provided in Section 6 thereof, a policy or certificate; that one of said policies or certificates is attached hereto as a part hereof; that said certificate issued to said contract holders was not cancelled after December 31, 1940 by the Lincoln National Life Insurance Company, nor by Fidelity Assurance Association, and continued to remain in full force and effect as long as the contract holder made the payments provided for in his contract; that a report of the total amount of insurance in effect was submitted monthly to the Lincoln National Life Insurance Company accompanied by a list of terminations and restorations and said monthly list was submitted after December 31, 1940 as theretofore, and included in said report was the total amount of insurance on persons entitled to insurance under the provisions of Section 6 of the contracts issued by Fidelity Assurance Association; that the names of said contract holders who signed the riders sent out with the aforesaid letter of December 31, 1940 were continued on said monthly report and lists after December 31, 1940, and premiums for the insurance on their respective contracts have at all times been paid to Lincoln National Life Insurance Company.

And affiant further says that the records and accounts of Fidelity Assurance Association show that Fidelity Assurance Association did not pay to the State of West Virginia, or any official thereof, any fee for license to do business as an insurance company for the year beginning April 1, 1941; that application for license and check for $20.00 in payment of fee for the year beginning April 1, 1941 were filed with the Auditor of the State of West Virginia; but

such application was returned by the Auditor and said [fol. 422] check was not cashed and was returned by the Auditor and said license for the year beginning April 1, 1941 was not issued.

And further this affiant saith not.

F. J. McNulty.

Taken, sworn to and subscribed before me this the 18th day of April, 1942. Walter J. Gribben, Notary Public in and for Ohio County, West Virginia. My commission expires December 9, 1949. (Seal of Notary.)

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January 25, 1941.

Honorable George A. Bowles, Commissioner of Insurance, State Corporation Commission, Richmond, Virginia.

Dear Mr. Bowles:

We acknowledge receipt of your letter of January 23 regarding the matter of a letter mailed from Wheeling, West Virginia on December 31 to our contractholders. We again assure you that this letter was not considered as solicitation for insurance and the Association did not have the slightest intent nor did it believe such a letter would be in violation of any law.

It is our intention to file application as an insurance company in the State of Virginia at the earliest date possible and we are progressing as fast as possible in the preparation of the financial statement as of December 31, 1940.

We regret very much that we are unable to furnish you at this time with a definite date as to when our application will be filed and we will write you in the near future as to [fol. 423] the approximate date when determined.

Very truly yours, F. J. McNulty, Vice President and Secretary.

FJMcN/CMH.

Copy

Thos. W. Ozlin, Chairman
Wm. Meade Fletcher, H. Lester Kooker

COMMONWEALTH OF VIRGINIA

STATE CORPORATION COMMISSION

RICHMOND

March 31, 1941.

Honorable F. S. Risley, President, Fidelity Assurance Association, Wheeling, West Virginia.

DEAR MR. RISLEY:

This will acknowledge the receipt of your letter, dated March 27, 1941, which is in reply to my letter of the 25th instant.

The statements made by you therein are quite gratifying. However, it is with extreme regret that we observe that no definite plan has yet been formulatd.

I note that you state that the Association does not yet have any insurance risks outstanding *not fully covered.* I do not fully comprehend what is meant by this statement. Please advise me as to the significance thereof at your earliest convenience.

In view of the indefinite character of the statements made in your letter, I do not feel that we can properly drop the matter of an additional bond or deposit, but this matter will be reviewed in the light of certain statements made by you, and any recommendation made will be dictated by that which our examination reveals.

[fol. 424] With kindest personal regards, I am

Very truly yours, Securities Division, (S.) Blake T. Newton, Jr., Director.

btn:rwn.

Copy

April 7, 1941.

Hon. Blake T. Newton, Jr., Director, Commonwealth of Virginia, State Corporation Commission, Richmond, Virginia.

DEAR MR. NEWTON:

Your letter of March 31 followed me around the country and caught up with me just as I was leaving for Wheeling on Saturday.

I am indeed sorry that my letter was not clear regarding the insurance risks outstanding. The Association has not solicited, nor has it issued any insurance policies since receiving its license on December 31, 1940.

As you know, the Association sent all income reserve series "B" holders, whose contracts were insurance protected, a request for permission to amend their contracts so that the Association could carry the risk. The entire amount of the required insurance is still carried by The Lincoln National Life Insurance Company or The Columbian National Life Insurance Company and that is what I meant by the statement that we did not have any insurance risks outstanding that were not fully covered.

Please remember me kindly to Mr. Chichester and Mr. Moore and with kindest personal regards to you, I am

Very truly yours, —— ——, President.

FsR:VLM.

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[fol. 425] Copy

Thos. W. Ozlin, Chairman
W. Meade Fletcher, H. Lester Hooker
N. W. Atkinson, Clerk of the Commission

COMMONWEALTH OF VIRGINIA
STATE CORPORATION COMMISSION
RICHMOND

April 10, 1941.

Mr. F. s. Risley, President, Fidelity Assurance Association, Wheeling, W. Va.

DEAR MR. RISLEY:

This will acknowledge receipt of your letter dated April 7, 1941.

The statements made by you with reference to the insurance risks outstanding clear up the questions that were raised relative to such risks in my letter of recent date.

I hope that at this time you are in a position to advise Mr. Bristow that a definite plan has been adopted for future operations, for we are extremely anxious, and I know you are, to see a resumption of activities with a minimum of delay.

With kindest regards, I am

Sincerely, Securities Division (S.) Blake T. Newton, Jr., Director.

BTNr•vdc.

(Here follow 4 photolithographs, side folios 426-429.)



# THE LINCOLN NATIONAL

## LIFE INSURANCE COMPANY

FORT WAYNE, INDIANA

**Certificate No.** E94-C27,140-P

Certifies that it has insured by a Multiple Life Policy or equivalent Individual Policies the lives of certain registered holders of Income Reserve Contracts, Series B, issued by

**Fidelity Investment Association**
**WHEELING, WEST VIRGINIA.**
(Herein called the Fidelity)

Subject to the terms and conditions of said Policy, the life of

George Golder Blake
(Herein called the Insured)

is insured thereunder against death for a progressively decreasing amount which, with interest compounded semi-annually at the rate of 4½% per annum, is at all times sufficient to enable the Fidelity, to whom said insurance is payable for the account of the Insured and upon receipt of said amount, to waive payment of all monthly payments (less certain deductions) not yet paid but which would otherwise be payable under the terms and conditions of its Income Reserve Contract, Series B, No. 340-11524 to be issued on or after the effective date of this certificate to the Insured as registered holder thereof, requiring monthly payments of $ 15.00 each.

The said Policy provides that the above described insurance shall terminate (a) if premiums are not duly paid thereon, or (b) when all monthly payments required by the Income Reserve Contract shall have been made.

THE LINCOLN NATIONAL LIFE INSURANCE COMPANY

FORT WAYNE, INDIANA

Certificate No. E94-C27,140-P

Certifies that it has insured by a Multiple Life Policy or equivalent Individual Policies the lives of certain registered holders of Income Reserve Contracts, Series B, issued by

**Fidelity Investment Association**
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Subject to the terms and conditions of said Policy, the life of

George Golder Blake
(Herein called the Insured)

is insured thereunder against death for a progressively decreasing amount which, with interest compounded semi-annually at the rate of 4½% per annum, is at all times sufficient to enable the Fidelity, to whom said insurance is payable for the account of the Insured and upon receipt of said amount, to waive payment of all monthly payments (less certain deductions) not yet paid but which would otherwise be payable under the terms and conditions of its Income Reserve Contract, Series B, No. 340-11524 to be issued on or after the effective date of this certificate to the Insured as registered holder thereof, requiring monthly payments of $ 15.00 each.

The said Policy provides that the above described insurance shall terminate (a) if premiums are not duly paid thereon, or (b) when all monthly payments required by the Income Reserve Contract shall have been made.

THE LINCOLN NATIONAL LIFE INSURANCE COMPANY

B. E. Kattell
Secretary

Effective Date January 17, 1935

Examined by

Form 2250-W—6-34—250

426

236A



# THE
# LINCOLN NATIONAL
# LIFE INSURANCE COMPANY

*FORT WAYNE, INDIANA*

1932

# The Lincoln National Life Insurance Company

FORT WAYNE, INDIANA

HEREBY INSURES the life of the person designated in Schedule A hereof as the Insured, for a period of one month following the date of this Policy, subject to renewal as hereinafter set forth, for an amount to be determined as prescribed, and payable to the Beneficiary designated in said Schedule, subject to the provisions on the second page hereof, which are hereby made a part of this Policy.

This Policy is issued in consideration of the application therefore and of the payment in the manner specified of a premium at the rate shown in Schedule B hereof for the age of the Insured, and based upon the amount of insurance in force on the date when such premium is due.

## SCHEDULE A

The Insured

Lawrence F. Brahm

Amount of insurance $ 676.00, or any less amount for which this Policy shall have been renewed, payable at the Home Office of the Company immediately upon receipt of due proof of the death of the Insured while this Policy is in force.

Beneficiary: The Fidelity Investment Association for the account of the Insured.

| Policy Number | Date of Policy | Age of Issue |
|---|---|---|
| E94-06569-P | 6/18/35 | 28 |

This Policy may be renewed monthly for one hundred twenty-eight consecutive terms of one month, unless the obligation protected by this Policy is sooner terminated, by the payment at the beginning of each such month of the premium for renewal at the rate shown in Schedule B for the age of the Insured (nearest birthday) at issuance of this Policy and the year of insurance, the amount of each premium to be based upon the amount of insurance to be renewed on the date when such premium is due, which amount shall not exceed the limits shown in Schedule B.

## SCHEDULE B

The amount of insurance hereunder during any policy month shall not exceed the then current limit of insurance per $676.00 of insurance during the first month, as shown in the following table. For example, if the first month's insurance is $1,352.00, the limits of insurance will be 200% of the amounts shown in the table: thus in the fourth month, $1,352.00; in the twentieth month, $1,292.00; in the forty-eighth month, $1,012.00.

| Month | Limit | Month | Limit | Month | Limit | Month | Limit | Month | Limit | Month | Limit |
|---|---|---|---|---|---|---|---|---|---|---|---|
| 1-14 | $676 | 33 | $581 | 52 | $486 | 71 | $384 | 90 | $270 | 110 | $149 |
| 15 | 671 | 34 | 576 | 53 | 481 | 72 | 378 | 91 | 264 | 111 | 139 |
| 16 | 666 | 35 | 571 | 54 | 476 | 73 | 372 | 92 | 258 | 112 | 132 |
| 17 | 661 | 36 | 566 | 55 | 471 | 74 | 366 | 93 | 252 | 113 | 125 |
| 18 | 656 | 37 | 561 | 56 | 466 | 75 | 360 | 94 | 246 | 114 | 118 |
| 19 | 651 | 38 | 556 | 57 | 461 | 76 | 354 | 95 | 240 | 115 | 111 |
| 20 | 646 | 39 | 551 | 58 | 456 | 77 | 348 | 96 | 234 | 116 | 104 |
| 21 | 641 | 40 | 546 | 59 | 451 | 78 | 342 | 97 | 228 | 117 | 97 |
| 22 | 636 | 41 | 541 | 60 | 446 | 79 | 336 | 98 | 222 | 118 | 90 |
| 23 | 631 | 42 | 536 | 61 | 441 | 80 | 330 | 99 | 216 | 119 | 83 |
| 24 | 626 | 43 | 531 | 62 | 436 | 81 | 324 | 100 | 210 | 120 | 75 |
| 25 | 621 | 44 | 526 | 63 | 431 | 82 | 318 | 101 | 204 | 121 | 68 |
| 26 | 616 | 45 | 521 | 64 | 426 | 83 | 312 | 102 | 197 | 122 | 60 |
| 27 | 611 | 46 | 516 | 65 | 420 | 84 | 306 | 103 | 191 | 123 | 53 |
| 28 | 606 | 47 | 511 | 66 | 414 | 85 | 300 | 104 | 184 | 124 | 45 |
| 29 | 601 | 48 | 506 | 67 | 408 | 86 | 294 | 105 | 178 | 125 | 38 |
| 30 | 596 | 49 | 501 | 68 | 402 | 87 | 288 | 106 | 171 | 126 | 30 |
| 31 | 591 | 50 | 496 | 69 | 396 | 88 | 282 | 107 | 165 | 127 | 23 |
| 32 | 586 | 51 | 491 | 70 | 390 | 89 | 276 | 108 | 158 | 128 | 15 |
| | | | | | | | | 109 | 152 | 129 | 8 |

The monthly premium hereunder for any month shall be calculated according to the following premiums per $1,000.00 of insurance.

| Year of Insurance | Age Group at Issue | | | | | |
|---|---|---|---|---|---|---|
| | 15-33 | 34-40 | 41-45 | 46-50 | 51-55 | 56-60 |
| | Mo. Prem. | Mo. Prem. | Mo. Prem. | Mo. Prem. | Mo. Prem. | Mo. Prem. |
| 1 | $0.69 | $0.77 | $0.88 | $1.15 | $1.59 | $2.29 |
| 2 | .69 | .78 | .93 | 1.22 | 1.71 | 2.47 |
| 3 | .70 | .79 | .97 | 1.30 | 1.84 | 2.67 |
| 4 | .71 | .81 | 1.05 | 1.39 | 1.98 | 2.88 |
| 5 | .71 | .83 | 1.09 | 1.49 | 2.13 | 3.11 |
| 6 | .72 | .83 | 1.15 | 1.59 | 2.29 | 3.38 |
| 7 | .73 | .88 | 1.22 | 1.71 | 2.47 | 3.64 |
| 8 | .74 | .95 | 1.30 | 1.84 | 2.67 | 3.93 |
| 9 | .75 | .97 | 1.39 | 1.98 | 2.88 | 4.25 |
| 10 | .77 | 1.05 | 1.49 | 2.13 | 3.11 | 4.60 |
| 11 | .78 | 1.09 | 1.59 | 2.29 | 3.36 | 4.97 |

The Insured

Lawrance F. Brehm

Amount of insurance $ 676.00, or any less amount for which this Policy shall have been renewed, payable at the Home Office of the Company immediately upon receipt of due proof of the death of the Insured while this Policy is in force.

Beneficiary: The Fidelity Investment Association for the account of the Insured.

| Policy Number | Date of Policy | Age of Issue |
|---|---|---|
| E94-06569-P | 6/18/36 | 28 |

This Policy may be renewed monthly for one hundred twenty-eight consecutive terms of one month, unless the obligation protectgd by this Policy is sooner terminated, by the payment at the beginning of each such month of the premium for renewal at the rate shown in Schedule B for the age of the Insured (nearest birthday) at issuance of this Policy and the year of insurance, the amount of each premium to be based upon the amount of insurance to be renewed on the date when such premium is due, which amount shall not exceed the limits shown in Schedule B.

| | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| 19 | 631 | 38 | 356 | 57 | 461 | 76 | 354 | 95 | 240 | 115 | 111 |
| 20 | 646 | 39 | 351 | 58 | 456 | 77 | 348 | 96 | 234 | 116 | 104 |
| 21 | 641 | 40 | 346 | 59 | 451 | 78 | 342 | 97 | 228 | 117 | 97 |
| 22 | 636 | 41 | 341 | 60 | 446 | 79 | 336 | 98 | 222 | 118 | 90 |
| 23 | 631 | 42 | 336 | 61 | 441 | 80 | 330 | 99 | 216 | 119 | 83 |
| 24 | 626 | 43 | 331 | 62 | 436 | 81 | 324 | 100 | 210 | 120 | 75 |
| 25 | 621 | 44 | 326 | 63 | 431 | 82 | 318 | 101 | 204 | 121 | 68 |
| 26 | 616 | 45 | 321 | 64 | 426 | 83 | 312 | 102 | 197 | 122 | 60 |
| 27 | 611 | 46 | 316 | 65 | 420 | 84 | 306 | 103 | 191 | 123 | 53 |
| 28 | 606 | 47 | 311 | 66 | 414 | 85 | 300 | 104 | 184 | 124 | 45 |
| 29 | 601 | 48 | 306 | 67 | 408 | 86 | 294 | 105 | 178 | 125 | 38 |
| 30 | 596 | 49 | 301 | 68 | 402 | 87 | 288 | 106 | 171 | 126 | 30 |
| 31 | 591 | 50 | 496 | 69 | 396 | 88 | 282 | 107 | 165 | 127 | 23 |
| 32 | 586 | 51 | 491 | 70 | 390 | 89 | 276 | 108 | 158 | 128 | 15 |
| | | | | | | | | 109 | 152 | 129 | 8 |

The monthly premium hereunder for any month shall be calculated according to the following premiums per $1,000.00 of insurance.

| Year of Insurance | Age Group at Issue | | | | | |
|---|---|---|---|---|---|---|
| | 15-35 | 36-40 | 41-45 | 46-50 | 51-55 | 56-60 |
| | Mo. Prem. | Mo. Prem. | Mo. Prem. | Mo. Prem. | Mo. Prem. | Mo. Prem. |
| 1 | $0.69 | $0.77 | $0.88 | $1.15 | $1.59 | $2.29 |
| 2 | .69 | .78 | .93 | 1.22 | 1.71 | 2.47 |
| 3 | .70 | .79 | .97 | 1.30 | 1.84 | 2.67 |
| 4 | .71 | .81 | 1.05 | 1.39 | 1.98 | 2.88 |
| 5 | .71 | .83 | 1.09 | 1.49 | 2.13 | 3.11 |
| 6 | .72 | .85 | 1.15 | 1.59 | 2.29 | 3.36 |
| 7 | .73 | .88 | 1.22 | 1.71 | 2.47 | 3.64 |
| 8 | .74 | .93 | 1.30 | 1.84 | 2.67 | 3.93 |
| 9 | .75 | .97 | 1.39 | 1.98 | 2.88 | 4.25 |
| 10 | .77 | 1.05 | 1.49 | 2.13 | 3.11 | 4.60 |
| 11 | .78 | 1.09 | 1.59 | 2.29 | 3.36 | 4.97 |

IN WITNESS WHEREOF, THE LINCOLN NATIONAL LIFE INSURANCE COMPANY has caused this contract to be signed on the day, month and year stated in Schedule A.

Arthur F. Hall
President

Examined by .....

*Renewable Monthly Term Policy, 129 Months Unless Obligation Terminates Prior Thereto, Decreasing Limit of Insurance, Non-Convertible, Non-Participating.*

FORM 2260—W—8-36—200

428

2360

## PROVISIONS

*Entire Contract.*—This Policy and the application therefor, a copy of which is endorsed upon or attached to this Policy, constitute the entire contract; and, in the absence of fraud, the statements made in the application shall be deemed representations and not warranties and no such statement shall avoid this Policy unless it be contained in the written application and a copy of such application be attached to or endorsed upon the Policy when issued.

*Modifications, etc.*—No person except the President, a Vice-President, the Secretary or an Assistant Secretary has power to change, modify or waive the provisions of this contract, and then only in writing. The Company shall not be bound by any promise or representation heretofore or hereafter made by or to any agent or person other than as above.

*Payment of Premiums.*—Premiums are due and payable in advance at the Home Office of the Company in the city of Fort Wayne, Indiana, but may be paid to an authorized agent of the Company only in exchange for the Company's receipt therefor signed by the President or the Secretary and countersigned by the agent as evidence of such payment. The payment of any premium shall not continue this Policy in force longer than the time for which the premium payment is made, except as otherwise provided herein.

*Grace Period.*—If any premium is not paid on or before the date it falls due, the policyholder is in default; but a grace of one month (not less than thirty days) without interest charge will be allowed in the payment of every premium after the first, during which time the insurance continues in force.

*Suicide.*—If the Insured shall commit suicide while sane or insane within two years from the date of issue hereof, the liability of the Company under this Policy will be limited to the premiums that have been paid hereon and no more.

*Incontestability.*—This Policy shall be incontestable after two years from date of issue, except for the non-payment of premium, but, if the age of the Insured has been misstated, the amount payable hereunder shall be such as the premiums paid would have purchased at the correct age.

*Assignment.*—No assignment of this Policy shall be binding on the Company until it be filed with the Company at its Home Office. The Company, by receiving or filing any assignment, does not assume any responsibility as to validity or sufficiency thereof. Any claim made under an assignment shall be subject to proof of interest and extent thereof.

*Indebtedness.*—Any indebtedness to the Company on account of or secured by this Policy will be deducted from any payment or any settlement hereunder.

*Reserve Basis.*—The reserve for this Policy shall be computed upon the American Experience Table of Mortality and 3½% interest per annum.

*Reinstatement.*—Should this Policy lapse, it may be reinstated at any time before the expiry of the months during which consecutive renewals of the Policy could have been made as provided herein, upon presentation of evidence of insurability satisfactory to the Company and upon the payment of all premium arrears with interest at 6% per annum.

*Control.*—The control of this Policy shall be vested in the beneficiary absolutely.

2361

COPY OF APPLICATION

[fol. 430] In United States Circuit Court of Appeals

Argument of Cause.

April 20, 1942, (April term, 1942) cause came on to be heard on the motions and on the merits before Parker, Soper and Dobie, Circuit Judges, and was argued by counsel and submitted.

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In United States Circuit Court of Appeals

Order Correcting Record—Filed and Entered April 20, 1942

On Consideration of the suggestion of Fyke Farmer, counsel for L. H. Brooks, consented to in Open Court by the parties hereto and it appearing that the certified transcript of record in the case of L. H. Brooks, et al. v. Fidelity Assurance Association, et al., was by error omitted from the transcript of the record in this case.

It Is Ordered that said transcript of record in the above entitled case be corrected by filing and adding thereto said omitted record.

April 20, 1942.

John J. Parker, Senior Circuit Judge.

Note: The certified transcript of record in L. H. Brooks, et al., vs. Fidelity Assurance Association, et al., appears at page 4429 of the complete certified transcript of record.

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In United States Circuit Court of Appeals

Stipulation—Filed April 20, 1942

Counsel admit at the Bar of the Court that the license applied for shortly prior to April 1, 1941, was issued but was in possession of the Auditor of West Virginia on June 6, 1941, and that the check sent in payment therefor was returned without being cashed prior to June 6, 1941, and that the Company was not operating under said license at the time of the filing of these proceedings on June 6, 1941; and that the total number of riders sent out on December 31, 1940, which were signed by contract holders and re-

turned to the Company, was 9,802; and that the total number of Series B contracts with insurance clause on Decem-
[fol. 431] ber 31, 1940, was 14,626.

J. Campbell Palmer, III, Rudolph K. Schurr, J. W. Rector, Ben C. Buckingham, H. Vernon Eney, Counsel for Appellants. Justin N. Reinhardt, John V. Ray, Counsel for appellee.

Approved April 20, 1942.

John J. Parker, Senior Circuit Judge.

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[fol. 432] In United States Circuit Court of Appeals, Fourth Circuit

No. 4923

Edgar B. Sims, Auditor of the State of West Virginia, and Ex-Officio Insurance Commissioner of the State of West Virginia; Ross B. Thomas and H. Isaiah Smith, West Virginia State Court Receivers; Banking Commission of Wisconsin; Chas. R. Fischer, Commissioner of Insurance and Permanent Receiver for Debtor Corporator in and for the State of Iowa; John B. Gontrum, Insurance Commissioner of the State of Maryland; Dewey S. Godfrey, Missouri State Court Receiver; and L. H. Brooks, Trustee, Frederic Leake and A. L. Goldberg, Jr., Trustee, Appellants,

versus

Fidelity Assurance Association, a Corporation, Debtor, Appellee

Appeal from the District Court of the United States for the Southern District of West Virginia, at Charleston

In Bankruptcy

(Argued April 20, 1942. Decided June 16, 1942)

Before Parker, Soper and Dobie, Circuit Judges

[fol. 433] James Ward Rector, Deputy Attorney General, State of Wisconsin; Fyke Farmer, Rickard H. Lauritzen, Assistant Attorney General, State of Wisconsin; J. Camp-

bell Palmer, III, and H. Vernon Eney (John E. Martin, Attorney General, State of Wisconsin; John M. Rankin, Attorney General, State of Iowa; Floyd Philbrick, First Assistant Attorney General, State of Iowa; Carl J. Stephens and Ben C. Buckingham; Guy B. Brown; Rudolph K. Schurr; Clarence W. Meadows, Attorney General of West Virginia, and Ira J. Partlow, Assistant Attorney General of West Virginia, on brief) for Appellants, and John V. Ray; Justin N. Reinhardt, Attorney, Securities and Exchange Commission; Homer Kripke, Special Counsel, Securities and Exchange Commission; T. C. Townsend and Dorr E. Warner (James R. Fleming; Townsend & Townsend; Hillis Townsend; W. J. Thompson; John T. Keenan, and Chester T. Lane, General Counsel, Securities and Exchange Commission, on brief) for Appellee.

OPINION—Filed June 16, 1942

SOPER, Circuit Judge:

The appeal in this case is from an order of the District Court of January 5, 1942, whereby the court approved the petition of Fidelity Assurance Association, a West Virginia corporation, praying for reorganization under Chapter X of the National Bankruptcy Act, and overruled certain motions to modify or rescind prior orders of the court with respect to the custody or control of securities deposited by the corporation with officials in fifteen states of the union. The appellants herein are intervenors in the bankruptcy proceeding, and include various state officials with whom the debtor had deposited securities, as required by state statutes, that is, the Auditor and Ex Officio Insurance Commissioner of West Virginia, the State Court Receivers in West Virginia, the Banking Commission of Wisconsin, the Commissioner of Insurance and Permanent Receiver [fol. 434] for the debtor in the State of Iowa, the Insurance Commissioner of Maryland, the State Court Receiver in Missouri, and certain contract holders in Tennessee. Since the Fidelity is now insolvent and its business operations have been discontinued, the appellants seek to uphold the authority of the state officials to apply the deposits in their custody for the benefit of local contract holders in accordance with the applicable state laws. A number of objections to the action of the District Judge are raised, but in the view we take of the case, it will be sufficient to consider only

two questions: (1) whether the Fidelity was an insurance company when the petition in bankruptcy was filed, and as such, was exempt from the provisions of the Bankruptcy Act; (2) whether the petition was filed in good faith within the meaning of that term in Chapter X of the statute.

The Fidelity was incorporated on April 11, 1911 in West Virginia, under the name of the Fidelity Investment and Loan Association, to buy, sell and deal in stocks, bonds and real estate. By charter amendment in November, 1912 its name was changed to Fidelity Investment Association and it was authorized to receive payments on annuity contracts in fixed installments or otherwise, and to sell certificates, bonds or other investment securities of any kind on the installment or any other plan of payment. Its original authorized capital of $100,000 was increased to $200,000 in 1912, $500,000 in 1926, $1,000,000 in 1929 and $13,000,000 in 1931. The total outstanding stock on December 30, 1940 was $911,000 of preferred and $812,300 of common. Of the preferred, $505,100 had been paid for in cash in that it was issued in exchange for annuity contracts surrendered by the holders and $405,900 of preferred had been issued as dividends on the common stock. Of the common stock, $195,873.34 had been issued for cash and $616,426.66 had been issued as dividends on the common stock.

From November, 1912 to the end of 1940, the Fidelity was engaged in selling its own securities in the form of investment contracts variously known as annuities, installments or, more recently, face amount certificates, and in investing [fol. 435] the funds received from the purchaser. This activity brought the corporation within the scope of Article 9 of Chapter 33 of the Code of West Virginia which required every person or corporation engaged in this business in the State to secure a license from the Insurance Commissioner of the State and to deposit with the State Treasurer, in trust for the benefit of the contract holders, securities approved by the Insurance Commissioner in the sum of $100,000; and in addition to maintain with the State Treasurer securities so approved equal in amount to the cash liabilities of the corporation under its contracts; provided that such additional deposits were not required to be made with respect to contracts sold in other states to the extent that the law of such states required deposits to be made therein for the benefit of local contract holders. Article 9 (5) of the West Virginia Code directed the Insurance Commis-

sioner to revoke the license of any corporation failing to makes the required deposits and to suspend the license of any corporation if he should find that its liabilities exceeded its assets; and Article 9 (10) of the Code gave the Insurance Commissioner the same authority over every corporation engaged in selling annuity contracts as over insurance companies, and empowered him, if he should be of the opinion that the assets of such a corporation were impaired, or that it was not complying with the law, to revoke its license; and if so, to retain authority and control over the deposits until the total liability of all the contracts issued by the corporation in the state should be redeemed or settled. Similar provisions are found in the statutes of fourteen other states in which the Fidelity sold annuity contracts and made the required deposits *. The Fidelity also [fol. 436] sold annuity contracts in fourteen additional states in which no deposit was required by law. In short, the Fidelity sold contracts in twenty-nine states and deposited securities for the benefit of the purchasers in fifteen states. The market value of the securities deposited in

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| *State | Amount of Deposit and Legal Nature | Statute |
|---|---|---|
| Alabama | Amount set by Sec. Comm'r and held in escrow | Tit. 53, Sec. 12 Ala. Code |
| Delaware | $100,000, up to 100% if required "in trust" | Ch. 66, Sec. 105 Rev. Code Del., 1935 |
| Illinois | $50,000, 100% if required (100% was required) "for the benefit of Illinois contract holders" | Ch. 121½, Sec. 101-a, Rev. Stats. 1939 |
| Iowa | 100% of liability "guaranteeing faithful performance" | Ch. 392, Iowa Code 1939 |
| Indiana | 100% of liability "for benefit of" Indiana creditors | Ch. 45, Art. 12 Baldwin's Ind. Statutes |
| Kansas | 100% of liability "for the benefit of" Kansas creditors | Ch. 17, Art. 10, Sec. 17-1033, Kans. Stats. |
| Kentucky | 100% of liability "for protection of contractholders" | Ch. 72-a, Carroll's Ky. Stats. 1936 |
| Maryland | 100% of liability "in trust" | Art. 48-a, Sec. 18-234 Ann. Code, 1939 |
| Missouri | 100% of liability | Rev. Stats. Mo. 1939 |
| Ohio | 100% of liability "for the protection of investors" | Ch. 20, Sec. 696, Page's Ohio Code, Ann. |
| Pennsylvania | $100,000 "as security for fulfillment of contracts" | Ch. 28, Tit. 7 Purdon's Pa. Stats. |
| Tennessee | 100% of liability "for benefit of Tennessee creditors" | Pt. 1, Tit. 14, Ch. 4, Michie's Tenn. Code, 1938 |
| Virginia | $25,000 collateral trust in discretion of Sec. Comm'r | Title 34-a, Ch. 147-a, Va. Code 1936, Ann. |
| Wisconsin | Liability not to exceed 90% of deposit maintained in trust for benefit of local members | Sec. 216.01 Wis. Stats |

each of the fifteen states as of June 6, 1941, when the pending suit was instituted, and the net cash liability of the Fidelity to the purchasers therein as of April 10, 1941 is shown by the following table:

| State | Deposit by States as of June 6, 1941 Market Value | Liabilities by States as of April 10, 1941 Net Cash |
|---|---|---|
| Alabama | $32,555.16 | $31,346.71 |
| Delaware | 293,790.63 | 290,175.36 |
| Illinois | 3,759,894.00 | 4,225,790.75 |
| Indiana | 162,863.44 | 386,173.45 |
| Iowa | 45,082.50 | 34,478.27 |
| Kansas | 83,337.50 | 108,784.89 |
| [fol. 437] | | |
| Kentucky | $86,712.50 | $92,690.42 |
| Maryland | 470,806.25 | 493,552.24 |
| Missouri | 861,100.62 | 786,988.86 |
| Ohio | 509,573.44 | 2,360,418.70 |
| Pennsylvania | 232,591.57 | 4,668,582.25 |
| Tennessee | 196,574.38 | 200,504.97 |
| Virginia | 27,703.13 | 557,809.19 |
| West Virginia | 10,674,696.08 | 6,896,393.88 |
| Wisconsin | 2,619,399.07 | 2,342,978.73 |
| | $20,056,680.27 | $23,475,668.67 |

In addition, the Fidelity had undeposited securities of the market value of $556,467.51 on June 6, 1941, and approximately $500,000 in cash.

In addition, the Fidelity had undeposited securities of the market value of $556,467.51 on June 6, 1941, and approximately $500,000 in cash.

On April 10, 1941, 87,999 contracts were outstanding with a face amount of $181,948,026.70 and cash liability of $23,475,668.67. The contract holders reside in each of the forty-eight states, the District of Columbia and in foreign countries.

The Securities and Exchange Commission, pursuant to Section 30 of the Public Utility Holding Company Act of 1935, 15 U. S. C. A. 792-4, undertook an investigation of the business of companies issuing face amount installment certificates, and made a report to Congress on March 13, 1940, in which one chapter was devoted to the Fidelity Investment Association. Based on this report Congress passed the Investment Company Act of 1940, 54 Stat. 789, 11 U. S. C. A. 80 (a), effective January 1, 1941, wherein it found that investment companies are affected with a "national public interest"; and enacted strict regulations to govern the sale of face amount certificates, that is, certificates, investment contracts or other securities which represent an obligation of the issuer to pay a stated sum at a fixed date

more than twenty-four months after the date of issuance, in consideration of the payment of periodic installments [fol. 438] of a stated amount. Upon the passage of this Act *, it was immediately apparent that the Fidelity would be unable to comply with the regulations, especially as to the permissible sales load and the reserve to be maintained with respect to the issued contracts. To meet this situation, another change in the corporate charter was made on December 31, 1940 whereby its name became Fidelity Assurance Company, and its objects and purposes were stated to be "to issue insurance upon the lives of persons and every insurance appertaining thereto and connected therewith and to grant, purchase and dispose of annuities."

On January 24, 1941, the charter was again changed so as to reduce the authorized capital to $1,000,000 of common stock of a par value of $8 per share. The resolution authorizing the change in the charter stated that it was the desire of the company to transact life insurance business outside the State of West Virginia, and that in order to accomplish this purpose, it was necessary that the stock of the company should be common stock of one class and of such amount as would leave a surplus satisfactory to the insurance departments of the several states. 18,220 shares of the new stock were to be issued in exchange for 9,110 shares of the outstanding preferred stock, and 8,123 shares were to be issued in exchange for 8,123 shares of the outstanding common stock. No stock was in fact issued, cancelled or exchanged pursuant to this provision prior to the institution of the pending case.

During the greater part of the period covered by this corporate history, that is, from 1912 to 1940, the Fidelity was engaged in the sale of annuity contracts. These took several different forms, but they were similar in their essential provisions. The purchaser agreed to make monthly payments of a stated amount for the period of 120 to 132 [fol. 439] months, and the Fidelity agreed to return to the purchaser, after the expiration of the period and of an additional waiting period from 3 to 13 months, a stated sum

* Registration under this Act by companies doing business in the State was required by Ch. 46 of the Acts of West Virginia of March 8, 1941, effective 90 days thereafter, whereby Ch. 33 Art. 9 of the West Virginia Code was repealed. See W. Va. Code, Ch. 32, Art. 3.

of money known as the face amount of the contract in monthly, quarterly or annual installments, in accordance with one of the optional plans of settlement selected by the purchaser under the terms of the contract. Each form of contract contained detailed provisions as to payments, cash surrender value, lapses and optional plans of settlement. The net return on the investment, if the contract was fully performed, varied from 1.55 to 3.09%. No surrender value was provided until 10 to 16 monthly payments had been made. If the contract lapsed during this period, all payments made by the purchaser were forfeited to the company. The surrender value did not equal the amount paid in until payments had been made from 6 to 9 years. The report of the Securities and Exchange Commission (p. 111) shows that during the 10 year period from 1927 to 1936, the lapsed contracts amounted to 91 to 93%, and the matured contracts to 7 to 9%, and that the contracts which matured during this period amounted to only 14% of those in force at the beginning of the period.

Three types of contract were issued prior to 1921; another between 1921 and 1925, and a fifth between 1925 and 1932. During the last mentioned period the growth of the business was very rapid so that in 1932 the company had assets of $25,000,000. The sales of contracts were greatly aided throughout the company's history by the confidence inspired by the deposit of securities under the laws of West Virginia and other states, and the salesmen of the company made constant reference to the security thereby afforded investors. In 1934 the Series B contract was first issued, and thereafter until the end of 1940, when the company ceased the sale of annuities, almost all the contracts took this form. It contained an optional insurance feature for an additional charge whereby in the event of the death of the purchaser before the maturity of the contract, funds were provided wherewith the contract would be paid up to maturity or the commuted value of a paid-up contract would be paid to the purchaser's estate. Seventy-five per cent of [fol. 440] the Series B contracts sold carried this feature, and a substantial number of the holders of the older contracts converted them into Series B contracts with insurance. The insurance was provided by a group insurance policy written by Lincoln National Life Insurance Company of Fort Wayne, Indiana. An older Series D contract was

still sold in Ohio, Kentucky and Alabama, since these states would not permit the sale of the Series B contract with insurance unless the company qualified to do business as an insurance company. Following the issuance of the Series B contract, the sales of the company stepped up greatly. $16,000,000 face amount certificates were sold in 1935, $25,000,000 in 1936, $40,000,000 in 1937 and $52,000,000 in 1918.

In December, 1938 the Securities and Exchange Commission filed a bill for injunction against the Fidelity in the District Court of the United States for the Eastern District of Michigan, alleging that certain practices of the company violated the fraud provisions of the Securities Act of 1933, 15 U. S. C. A. 77 (a) et seq.; and on December 22, 1938 a consent decree was entered whereby the Fidelity was enjoined inter alia from failing to meet the deposit requirements of the several states; from failing to maintain separate contract reserve funds or required reserves; from paying dividends except from earned surplus; and from obtaining money or property by making false or misleading statements. See S. E. C. Report 257. In the same month a suit for the appointment of receivers was brought by certain contract holders against the Fidelity in the Northern District of West Virginia based on the facts developed in the suit in Michigan; but the bill was dismissed in the District Court and this action was affirmed by this court on August 28, 1939 in *Hutchinson* v. *Fidelity Inv. Ass'n.*, 106 F. 2d 431, as it was shown that the company was not then insolvent when its assets were appraised in accordance with the "sound value formula prescribed by the insurance Commissioner of West Virginia". These cases did not put an end to the company's activities, but they produced much unfavorable publicity and its business declined so rapidly in volume that in 1940 the total sales were less [fol. 441] than $12,000,000 and by April 1941 the liabilities of the company exceeded the assets by $2,500,000.

The force of these circumstances and the requirements of the Federal Investment Company Act of 1940 led the Fidelity to secure the change in charter on December 30, 1940 so as to authorize it to conduct a life insurance business. The company also paid for and obtained a license from the Auditor and Ex Officio Insurance Commissioner of West Virginia to do a life insurance business in the state for the period ending March 31, 1941. Proposed forms of new

annuity and life insurance policies were filed with the Insurance Commissioner of West Virginia pursuant to requirements of the state law as a condition precedent to the sale of such policies. An informal understanding or gentleman's agreement was reached with the Insurance Commissioner that the company would not sell insurance policies or annuity contracts until he gave it permission, but might continue to collect installments on the annuity contracts then in force. Application for a renewal of the license for the year beginning April 1, 1941 was made by the company in due course but the Commissioner withheld it and shortly thereafter directed the company to cease business.

In the meantime, however, the company had issued a substantial number of policies of insurance in the following manner, without requiring payment from the insured. At the meeting of the Board of Directors on December 31, 1941 it was determined that the Fidelity should agree to assume the insurance risks involved in the majority of the Series B contracts, and accordingly duplicate riders were sent to all of the holders of such contracts to the number of 14,626; and of these 9,802 signed riders and returned one to the company, whereby it assumed the obligations of the insurer, as set out in the contract. The company continued to pay the premiums on the group policy issued by the Lincoln National Life Insurance Company so as to continue it in force.

On April 4, 1941, the Auditor of West Virginia directed [fol. 442] the Fidelity to discontinue business and to segregate payments thereafter made by contract holders. On April 11, 1941 he filed a bill in the Circuit Court of Kanawha County, West Virginia, pursuant to Chapter 33, Article 2, Section 45 of the State Code which provided that whenever any company under the supervision of the Insurance Commissioner should become insolvent, the auditor might file a suit and take possession of its property and distribute its assets amongst the persons entitled thereto. The Fidelity appeared in this suit but filed no objection and receivers were appointed by the court. They took possession of the cash and undeposited securities, but not the securities in the hands of the State Auditor. That official notified the proper officials in other states, and proceedings were instituted in Indiana, Ohio, Illinois, Tennessee, Kansas, Kentucky, Missouri, Pennsylvania, Iowa and Maryland. In Wisconsin, the Banking Commission promptly proceeded to administer

the company's affairs, as provided by the state law, received claims from 6,000 local contract holders and realized the sum of $1,259,244.04 by the sale of deposited securities at prices in excess of the company's valuation of December 31, 1940.

On June 6, 1941, the Fidelity filed a petition in the instant case alleging insolvency and prayed for reorganization under Chapter X of the Bankruptcy Act. On the same day the District Judge entered an ex parte order wherein the petition for reorganization was approved, a trustee for the debtor was appointed and the West Virginia receivers and other persons were enjoined from disposing of any of the debtor's property and the state receivers were directed to turn over all the property in their hands to the trustee. On June 10, 1941, by another ex parte order all state officials in West Virginia and in other states were directed to deliver to the trustee all property of the debtor in their hands. The West Virginia receivers turned over the property in their hands under protest and the Ohio receiver turned over to the trustee without protest the property of the debtor in his possession. The state officials generally retained possession of the deposits in their custody.

[fol. 443] The auditor and the West Virginia receivers immediately appealed from these orders to this court. On August 9, 1941 the District Court modified the orders of June 6 and 10th by eliminating the turnover provisions, so that they merely enjoined the receivers and the Insurance Commissioners from selling or otherwise disposing of any of the assets of the debtor in their possession. Since the receivers and state officials of a large number of states were affected by the injunction order, but only those from West Virginia were parties to the appeal, and since a number of questions going to the jurisdiction were raised and the record was fragmentary, we declined to pass upon the questions involved and affirmed the interlocutory order without prejudice to the rights of the appellants or any other parties to the proceeding in the District Court with respect to any question there pending. See *Sims* v. *Central Trust Co.*, 123 F. 2d 89. Subsequently the Insurance Commissioners and officials of other states and receivers appointed by state courts were permitted to intervene and file answers controverting the allegations of the petition. The Security and Exchange Commission intervened at the request of the

court. After extended hearings, the order appealed from was filed.

We first consider the contention that the petition in bankruptcy should be dismissed because at the time it was filed in the District Court, the Fidelity was an "insurance corporation" within the meaning of Section 4 of the Bankruptcy Act, as amended by the Act of June 25, 1910, 36 Stat. 839, 11 U. S. C. A. 22. Thereby municipal, railroad, insurance and banking corporations are excepted from the provisions and benefits of the Act. The District Judge held that the Fidelity was not an insurance company within this exception, and was therefore entitled to file a petition for reorganization under Chapter X of the statute. His view was that in determining such a question, the charter of the corporation must first be examined, and if it appears that it is authorized thereby to engage in the excepted field and actually conducts its principal business in that field, it is excluded from the purview of the Act; but if the charter [fol. 444] also authorizes the corporation to do business in other fields, and all of the business is done in these fields, then the corporation is not an insurance company and is entitled to file a petition in bankruptcy. Finding as a fact that the Fidelity had never issued any insurance contracts but had been engaged only in selling annuities, he concluded that it was not an insurance corporation.

It should be noted at this point that, for some reason that is not entirely clear, the attention of the District Judge was not called to the fact now admitted, that after the Fidelity amended its charter and secured a license on December 31, 1940 to engage in the business of life insurance in West Virginia, it issued 9,802 contracts of insurance prior to April 1, 1941 in the manner above described. Since it issued no other new contracts of any kind during this period, but merely supervised its old outstanding annuity contracts, it is by no means certain that it did not fall within the statutory exception even under the rule of law announced by the District Judge. But this question need not be decided now, for, in our opinion, the scope of the provision by which municipal, railroad, insurance and banking corporations are excepted from bankruptcy proceedings is to be determined in any case by the classification of the corporation under the law of the state of its creation rather than by the character of its predominant business activity.

It must be borne in mind that we are not now dealing with the inclusive words of Section 4 of the Bankruptcy Act, but with words of exception, and that the considerations which determine the content of one class do not necessarily apply to the other. From time to time Congress has changed the description of the persons or corporations to whom the privileges of bankruptcy may be accorded. Thus the provisions of the Act of 1867, §37, 14 Stat. 535, were made applicable to moneyed business and commercial corporations; and these words were interpreted to include railroad companies, insurance companies and banks, while excluding municipalities. The Act of 1898, 30 Stat. 547, changed the description of the included class and granted the privilege of bankruptcy to corporations engaged principally in manu- [fol. 445] facturing, trading, printing, publishing, mining or mercantile pursuits; and it was under this Act that the courts held that the susceptibility to bankruptcy of a corporation does not depend upon its charter, but upon what it actually does. See, *In re Kingston Realty Co.*, 2 Cir. 160 F. 445; *Cate* v. *Connell*, 1 Cir., 173 F. 445. These decisions were especially persuasive in considering a statute whose criterion was the business in which the debtor was "engaged principally", but they have been cited in more recent cases and are relied upon by the appellee in the pending case with little reference to the change of verbiage in Section 4 of the Act that has subsequently taken place. See, *In re Dairy Marketing Ass'n. of Fort Wayne, D. C. Inc.*, 8 F. 2d 626; *In re Roumanian Workers Educational Ass'n.*, 6 Cir., 108 F. 2d 782.

The test established by the Act of 1898 excluded railroad, insurance and banking corporations, but it gave rise to difficulties of legal definition and controversies of fact that impeded the administration of the law; and therefore the Amendment of 1910, now contained in Section 4 of the Act, restored the words of the Act of 1867 and with certain exceptions again made bankruptcy available to "any moneyed, business or commercial corporation". We may assume for the purposes of the pending case that when a bankruptcy court is called upon to decide whether a corporation debtor is a moneyed, business or commercial corporation within the general phrase, it should ascertain what has been the principal business of the debtor and be governed accordingly. See, *In re Wisconsin CoOperative Milk Ass'n.*, 7 Cir., 119

F.2d 999; *Finletter*, The Law of Bankruptcy Reorganization, pp. 107-9; *Gerdes* 1 Corporate Reorganization, 165. But we must still determine what reasons led Congress to exclude municipal, railroad, insurance and banking corporations from the purview of the Act, and what interpretation should be given to the excepting clause. Had it not been for this clause, railroad, insurance and banking corporations would again have become subject to bankruptcy by the restoration of the inclusive words of the Act of 1867. [fol. 446] The purpose of the exclusion, we think, was correctly described by Judge Sibley in the following passage from *In re Supreme Lodge of the Masons Annuity*, D. C. N. D. Ga., 286 F. 180, 184, which has found wide acceptance in the federal circuits:

"• • • No reasons for making these exceptions were assigned by the committees of Congress, but they may be surmised to lie in the public or quasi public nature of the business, involving other interests than those of creditors, in the desirability of unarrested operation, the completeness of state regulation, including provisions for insolvency, and the inappropriateness of the bankruptcy machinery to their affairs.

These considerations all apply to insurance corporations. That the business generally may be declared affected with a public interest and subject to extensive regulation was recognized in German Alliance Ins. Co. v. Kansas, 233 U. S. 389, 412, 34 Sup. Ct. 612, 58 L. Ed. 1011, L. R. A. 1915 C, 1189. All states, probably, have in fact regulated insurance companies of all kinds, and provided for their liquidation. The affairs of an embarrassed or insolvent insurance company often require much technical skill and judgment and time for their adjustment and a carrying forward of the business, to prevent lapses and to permit reinsurance to simplify them. And considering the variety of insurance obligations assumed and the various statutes thereof, a chief practical difficulty is the ascertainment of who are really to be considered creditors and in what amounts, often requiring much time and elaborate accounting for its solution. Under such circumstances even the election of a trustee in bankruptcy could be difficult, and a creditors' meeting could hardly prosecute any business, owing to conflicting interests of the various classes of claims."

This view was again expressed in the same circuit (5th) in *Woolsey v. Security Trust Co.*, 5 Cir., 74 F. 2d 334, 337. The court said:

"The letter of that section excludes banking and insurance corporations; its spirit and purpose, to leave the liquidation of the banking corporations of the country to the well organized departments of the states and the nation, organized for the purpose of supervising while they are going concerns and of liquidating them when they are not, [fol. 447] excludes them. Federal laws provide elaborately for the supervision and liquidation of national banking corporations; the laws of the states do the same for state banks and insurance companies, in order to protect the millions of persons who deal with them on the faith of the protection afforded by direct governmental supervision and control. It was considered that it would be a ruinous thing to the state, to the depositors, and to the creditors to have the elaborate scheme of liquidation which the state provides broken into and nullified by bankruptcy proceedings, and it was intended, by withdrawing jurisdiction over these corporations from the bankruptcy court, that this would not occur. It would be directly contrary to the purposes so definitely and comprehensively expressed, to exempt banking corporations from the act, leaving their administration and liquidation to the state and federal systems devised expressly for them, to hold that this bank and trust company is not exempt, chartered though it was under the state banking laws, with banking privileges and powers, operated though it was under those laws, and now being liquidated, as it is, under them".

See also, *Grand Lodge, Knights of Pythias* v. *O'Connor*, 5 Cir., 95 F. 2d 474.

The interpretation of the exceptions has been outlined in other decisions where it has been pointed out that since Congress did not define the characteristics of the excepted corporations, the state statutes must be looked to in each case in order to determine the correct classification. Thus in *In re Union Guarantee & Mortgage Co.*, 2 Cir., 75 F. 2d 984, 985, the court said:

"The purpose of the exception is not self-evident; we must infer it as best we can from such similarity as exists between the excepted groups. All except municipalities are

companies for profit whose businesses are now generally regarded as 'affected with a public interest'; that is to say, as touching enough persons who must deal with them at some economic disadvantage, to require public supervision and control. And municipalities are even more directly within public control. The most natural inference is that Congress meant to leave to local winding up statutes the liquidation of such companies that, since the states commonly kept supervision over them during their lives, it was reasonable that they should take charge on their demise. [fol. 448] Columbia, etc. Co. v. South Carolina, 27 F. 2d 52, 59 A. L. R. 665 (C. C. A. 4); In re Grafton G. & E. Co. (D. C.) 253 F. 668. Cf. In re Hudson River Power Co., 183 F. 701, 33 L. R. A. (N. S.) 454 (C. C. A. 2). Now it is the powers conferred upon the company, not its activities, which are decisive. Gamble v. Daniel, 39 F. 2d 447 (C. C. A. 8); Clemons v. Liberty Savings, etc. Co., 61 F. 2d 448 (C. C. A. 5). So far as In re Supreme Lodge of Masons Annuity (D. C.) 286 F. 180, holds otherwise it cannot be accepted. If a state enacts that companies having powers of a prescribed kind must be regulated, that is of course authoritative; and, if in addition it classes the company as a bank or a railroad or an insurer, that too should be authoritative. Kansas v. Hayes, 62 F. 2d 597, (C. C. A. 10); Security B. & L. Ass'n. v. Spurlock, 65 F. 2d 768 (C. C. A. 9). This is true, not because Congress was bound to yield in such cases, but because otherwise its apparent purpose to leave the winding up of such companies to the state would not be effected; for the will of the state is no clearer to supervise the company than to class it as it does. When Congress excepted not all companies affected with a public interest, but specified kinds of such company, presumably it intended the states to define the kinds.

* * *What Congress meant by an insurance company in the income tax law has nothing to do with its meaning in the Bankruptcy Act. It is true that this makes the meaning of Section 4 depend upon local laws and subjects that meaning to change as those laws change; pro tanto, Congress has delegated its power. But this is not the only instance in the Bankruptcy Act; thus exemptions are dependent upon local law, section 6, 11 U. S. C. A. § 24, and so are the priorities among claims, Section 64 b (7) as amended, 11 U. S. C. A. § 104 (b) (7). Hanover National

Bank v. Moyses, 186 U. S. 181, 22 S. Ct. 857, 46 L. Ed. 1113; Stellwagen v. Clum, 245 U. S. 605, 38 S. Ct. 215, 62 L. Ed. 507. It is by no means true that Congress may in no circumstances delegate its powers to the states, provided that in the mean the resulting system be uniform.'"*

In *State of Kansas* v. *Hayes*, 10 Cir., 62 F. 2d 597, 599, the court said:

[fol. 449] "It is thus seen that under the many provisions of the statutory law of this state trust companies are made banking corporations. That it was not intended by the Legislature of the state that trust companies should be operated, or, in case of insolvency, the affairs of such corporations should be wound up in bankruptcy, the assets converted into cash and distributed under the provisions of the Bankruptcy Act, and that a discharge of the corporation, and its stockholders and directors should be granted from its remaining indebtedness. Of course, it is undoubtedly within the power of Congress to make trust companies of the state, or any other natural or corporate body, or unincorporated company subject to the National Bankruptcy Act, and, if this were done in clear and unequivocal terms, all state laws for their operation in conflict with the act must then be held to yield to the higher force, the national law. But, in the absence of any such express provision of the National Bankruptcy Act, in view of the state laws to which we have referred, and others, it must be held, we think, the provisions of the National Bankruptcy Act do not apply."

Like reasoning was employed in interpreting the meaning of the exception of building and loan associations from bankruptcy by the Act of February 11, 1932, 47 Stat. 47. With respect to this additional exception, it was said in *Security Building & Loan Ass'n* v. *Spurlock*, 9 Cir., 65 F. 2d 768, 770-1:

"* * * It is suggested that this phrase, 'building and loan association' might well be interpreted uniformly by

* The statement in In re Supreme Lodge of the Masons Annuity, 286 F. 180, 183, that a corporation, which is an insurance corporation in the meaning of Congress is such in every state, regardless of the name locally attributed to it, is expressly disapproved in this decision, and is also impliedly disapproved in the later decision in the Fifth Circuit cited above.

the federal courts in exercising bankruptcy jurisdiction disregarding the definition thereof by the authorities of the individual states whether such definition is legislative or judicial, and that, consequently, we must seek for a reasonable definition of a term of general application and then determine whether the local legislation authorizes the incorporation of such a building and loan association and also whether the alleged bankrupt is such a corporation or association. However desirable such a conclusion might be, the fact is that a building and loan association is entirely a creature of state statute and the statute authorizing its creation must necessarily define its characteristics. Consequently, we must look to the state statutes to determine the nature and character of the corporate organizations it authorizes to function as building and loan associations. If may be conceded that the mere name of 'build- [fol. 450] ing and loan association' would not control in the determination of the question as to the character of the corporation, although the fact that the corporation is designated in its name and in its articles of incorporation as a building and loan association is certainly persuasive, if not controlling, evidence of its character.

* * * when Congress enacted this legislation without any attempt to define the characteristics of the building and loan associations intended to be excluded from the operation of the Bankruptcy Act, it necessarily recognized the various definitions thereof in the statutes of the several states as indicating what constitutes a building and loan association in the respective states. To attempt by judicial construction to incorporate into the federal law some definition of a building and loan association would be in effect to legislate upon that subject. Congress was satisfied to take the state statutes as they found them and we must do so."

These authorities establish the rule that in determining whether a corporate debtor is a member of the excepted classes, the provisions of the state law must be given predominating influence. This is not to say that the classification of a state statute must be followed literally in every instance without any regard whatsoever to the real activity of the corporate body. The course of decisions, even in the Second Circuit, where perhaps the rule of state classi-

fication has been most strongly stated, indicates that the spirit rather than the letter of the local statutes should prevail; *In re Prudence Co.*, 2 Cir., 79 F. 2d 77. *Empire Title & Guar. Co.* v. *United States*, 2 Cir., 101 F. 2d 69; and the mere fact that a state may have provided for state supervision and liquidation of a kind of corporation does not of itself bring them within the excepted class. *In re Prudence Co., supra; Capital Endowment Co.* v. *Kroeger*, 6 Cir., 86 F. 2d 976.

Exclusion of the debtor from bankruptcy in the pending case does not call for an extreme or literal application of the rule of state classification. It is true that for many years the debtor dealt exclusively in the sale of annuity contracts and assumed the status of a life insurance company only a short time before the receivership under a [fol. 451] stress of circumstances that finally put an end to its business altogether. But the change was actually made, and the debtor did engage in the business of life insurance during its last three months of activity by the issuance of thousands of life insurance policies, while continuing to a limited extent its annuity business. This combination of activities is precisely that which a life insurance company in West Virginia is authorized to perform by Chapter 33 Article 3 Section 7 of the West Virginia Code, which is as follows:

"Life insurance companies chartered by and doing business in this state, and empowered to make contracts contingent upon life, may grant and issue annuities, either in connection with or separate from contracts of insurance based upon life risks, and all such annuities heretofore issued by such companies shall be valid."

There can be no doubt, therefore, that the Fidelity, by reason of its twofold activities, should be classified as an insurance company under the West Virginia law. Since the company deliberately assumed this new character to escape the requirements of the new federal and state statutes with respect to annuity companies, no weight should be given to the company's attempt to pose as an annuity company in the pending petition in bankruptcy. Moreover, the corporation would have been classed as an insurance company under the laws of the majority of the states as they existed

in 1910, when the excepting clause in the Bankruptcy Act was passed. At that time, the laws of twenty-eight states*, including West Virginia, classified a life insurance company as a corporation formed to insure the lives of persons and to grant, purchase and dispose of annuities; and since 1910, [fol. 452] seven additional states** have amended their statutes to include a like provision. The conclusion is that the Fidelity was an insurance company in 1941, whether its

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*Revised Statutes of Arizona (1901) Title 13, Ch. 3, Insurance Corporations, §797; California Political Code (1909) §594; Colorado Rev. Stat. (1908) §3116, p. 841; General Statutes of Connecticut (1902) §3540; Revised Statutes of Illinois, Hurd (1909) Ch. 73, Insurance, §177; Burns' Annotated Indiana Statutes, Revision of 1908, Vol. 2, §4678; General Statutes of Kansas, Dassler, (1909), §4111; Statutes of Kentucky, Russell (1909) Life Insurance and Life Insurance Companies, Art. 7, §4366; Marr's Annotated Revised Statutes of Louisiana, Vol. 2, p. 1217; Public General Laws of Maryland, (1904) Vol. 1, Art. 23, §148; General Laws of Massachusetts (1921) Vol. 2, Ch. 175; §118; Compiled Laws of Michigan, (1915) Vol. 2, p. 3375; Revised Laws of Minnesota (1905) §1687; Mississippi Code (1906) §2598; Revised Statutes of Missouri (1909) Vol. 2, §6895; Revised Codes of Montana (1907) §4016; Compiled Statutes of New Jersey (1709-1910) Vol. 2, p. 2838; "Act of Mar. 17, '09; L. '09; C. 48, §25" New Mexico Statutes Annotated (1915) §2846; Consolidated Laws of New York (1909) Vol. III, Art. 2, §70; Revisal of 1905 of North Carolina, Vol. 2, §4773; Revised Statutes of Ohio (1910) Vol. 2, §9339; Compiled Oklahoma Statutes, (1921) §6666; Lord's Oregon Laws (1910) Vol. 2, §4629; Brightly's Digest of Laws of Pennsylvania (1893-1903) p. 342; Vernon's Sayles' Texas Civil Statutes (1914) Vol. 3, Article 4724; Remington & Ballinger's Annotated Codes and Statutes of Washington, Vol. 2, §6123; West Virginia Code (1907 Supp.) §1107 a 17; Wisconsin Statutes (1911) §1897.

**Digest of Statutes of Arkansas (1937) Pope, Vol. II, Sec. 7647; Idaho Code Annotated (1932) Title 40, secs. 301, 304; Code of Iowa (1935) Ch. 398, sec. 8673-el.; Public Laws of New Hampshire (1926) Vol. 2, Ch. 272, sec. 1, III; Revised Statutes of Utah (1933) Title 43, Ch. 3, sec. 2 (1); Public Laws of Vermont (1933), Ch. 277, Insurance Companies, sec. 6911; Wyoming Revised Statutes (1931) Ch. 57, sec. 223.

classification as such depends upon the statutes of West Virginia or upon the classification which prevailed generally amongst the states of the union when the Amendment was enacted. That Amendment excludes the corporation from the benefits of the Bankruptcy Act.

This conclusion leads very easily to a consideration of the contention of the appellants that the petition in bankruptcy should be dismissed under Section 144 of the Chandler Act, 11 U.S.C.A 544, for the additional reason that it was not filed in good faith as that term is employed in Section 146 of the Act, 111 U.S.C.A. 546. Section 144 provides that if a controversial answer is filed by any creditor to the petition, the judge shall determine the issues presented and enter an order approving the petition if satisfied that it complies with the requirements of Chapter 10 and has been filed in good faith, or dismissing it if not so satisfied.

Section 146, insofar as material here, provides:

"Without limiting the generality of the meaning of the term 'good faith', a petition shall not be deemed filed in good faith if—

[fol. 453] "(1) • • •

"(2) • • •

"(3) it is unreasonable to expect that a plan of reorganization can be effected; or

"(4) a prior proceeding is pending in any court and it appears that the interests of creditors and stockholders would be best subserved in such prior proceeding."

Our attention is drawn to Section 146 (4) and to the question whether the interest of the contract holder will be best served by the continuance of the receivership proceeding instituted in the Circuit Court of Kanawha County in April 1941. In considering this question the discussion will be limited to the interests of the creditors, for it is apparent that the stockholders have no interest in the business. Commenting on the condition of the company's business, the District Judge said in his opinion: (*In re Fidelity Assur. Ass'n.*, 42 F. Supp., 973, 985-6)

"The proceedings are not yet at a stage where the court is called upon to consider any particular plan of reorganiza-

tion. It is true that the broad picture developed by the testimony at the hearing does not present a very favorable view with respect to the rehabilitation and continued operation of the Debtor as a face amount certificate company. Whether the Fidelity plan is fundamentally unsound depends upon the definition given to that term. It is apparent that it is a plan of investment which yields a very low rate of income to the investor and subjects the investor to substantial loss should he cease to pay the required installments during the earlier stages of the contract; but this very element of weakness from the investor's standpoint strengthens the company from an operating viewpoint, provided the contracts can be sold in sufficient volume to take care of necessary overhead expenses. It is extremely doubtful whether, in view of unsettled economic conditions and the critical international situation, the Fidelity plan would any longer appeal to a large public; but it is not impossible; and it is not the duty of the court to decide for the public that investors will not or should not buy these contracts in the future.

The fact that the company has not been operated profit-
[fol. 454] ably in the past is not shown to be the result of financial unsoundness in the plan itself. It has been due rather to an unsoundness in Debtor's methods of management. Extravagant sales and promotion expenses; useless expenditures for lavish offices, including the home office building at Wheeling, West Virginia; overexpansion, particularly in states like Wisconsin, where the strictness of regulatory state laws made it impossible to operate at a profit; poor judgment in selection of the personnel to manage the company; these are the elements of unsoundness which have brought about the difficulties in which Debtor now finds itself.

The requirements of the Investment Company Act of 1940, establishing 7% of the total amounts paid in on contracts during their entire life as the maximum loading charge, are calculated to make the contracts more saleable, and, with proper economy and good judgment on the part of the management, a reasonable profit to the operating company is possible. This regulatory law has not had the effect of banishing all such companies from the region of commercial operation. The testimony discloses that at least one other such company is still in operation, presumably with some measure of success.

To conclude that unfavorable publicity concerning the affairs of any company must affect that company's prospects of future operation after being reorganized under Chapter X is to lose sight of the very purpose of such a reorganization. All the unfavorable publicity has been directed towards the unreorganized company. What I have said above concerning the reasons for the company's present financial condition indicates that in my opinion such unfavorable publicity has been amply justified; but it does not follow that if and when the company may be reorganized under the supervision of a United States Court it would retain any of the stigmata which it is the purpose of such reorganization to remove."

This resume of the District Judge presents a dark picture of the company's future. Nevertheless it suggests that some plan of reorganization not yet formulated,* much less [fol. 455] proposed by any person financially able to carry it into effect, may not be impossible. We think it is our duty to review the situation realistically, and when this is done, there appears to be no reasonable hope of a reorganization of the business as a going concern, but only the immediate need of a liquidation of the company's assets for the benefit of the contract holders. Obviously there will be nothing left for the stockholders.

This conclusion is based in part upon the facts summarized in the quotation from the judge's opinion. For years past the business has not been profitable. In 1933 the company's liabilities exceeded its assets by $7,000,000. It recovered from this condition to such an extent that when the pending suit was filed in 1941, the unfavorable balance had been reduced to two and a half millions, and this was due in part to the rise in value of the company's securities and in part to the large increase in sales of annuities from an intensive sales campaign. But the improved situation was shattered when the suits were filed against the company in Michigan and in West Virginia in 1938 and 1939, and the company reaped a harvest of unfavorable publicity deservedly based upon its mismanagement and irregular

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* Some memoranda looking toward the formation of plans have been prepared but they do not purport to represent the proposal of any of the interested parties or to be sufficiently definite for submission to the creditors

transactions. The result was that a gross business of $52,000,000 in 1938 shrank to less than $12,000,000 in 1940, and the company was then losing money at the rate of $250,000 per year. Not a single contract has been sold since December 31, 1940 and the sales force upon which the life of the business depended has been dissipated and could be restored only at a cost of $500,000. Moreover, as the District Judge point- out, it is quite doubtful whether this form of investment presents any further appeal to a public that has now been informed as to the nature of the business;* certainly the possibility that thousands of contract holders [fol. 456] could be persuaded to modify their contracts and scale down their claims to enable the company to go on is so remote as to exist only in the imagination. No proposal for the investment of new capital has been forthcoming. The facts underlying the whole situation are so clear that even the parties in this case who insist upon reorganization under the Bankruptcy Act hold out little hope of a resumption of the business as a going concern, and content themselves for the most part with the argument that reorganization in the statutory sense includes "a slow and orderly liquidation".

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* The S. E. C. report (p. 113) compares the experience of a Series B contract holder without insurance with the experience of a holder of United States Savings Bonds over a period of ten years, based in each instance upon an investment by a purchaser of $100. The report states: "Throughout the 10 years of the comparison, the amounts recoverable to investors at any time are in favor of the United States Savings Bonds, the percentage of advantage ranging from 184.2% in the first year to 49.3% in the second year to 0.3% in the tenth year. Significant, too, is the fact that the United States Savings Bonds, bearing interest at the rate of 2.9% compounded semi-annually, have a greater aggregate value at the end of 10 years than the investment certificates of the Association, notwithstanding the "reserve fund" provisions of the certificates requiring the appropriation of installments received, less fixed but un-specified charges for administrative and agency expenses, together with interest thereon at 4½% compounded semi-annually. The difference shown by the comparison emphasizes the high costs deducted by the Association and borne by the purchasers of the certificates."

But, it is said that even if liquidation is inevitable, the interests of creditors would be best served by a retention of the case in the federal court. The argument is that in such event, the trustees would have title not only to the assets in West Virginia but also to the assets in all other states in which contracts were sold and deposits were made to secure them, that is, the trustee would have title not only to the ten million of deposits in West Virginia, but to the almost equal sum held by the authorities of the other states. Hence, it is said a more effective marshalling of assets and adjudication of claims could be had in the bankruptcy court than in the state court of West Virginia, since the receivers of the latter would have jurisdiction only over the assets in that state and would have no power under the established rule to bring suit to secure assets or surplus deposits held in other states. See, *Booth* v. *Clark*, 58 U. S. 339; *Great Western Mining Co.* v. *Harris*, 198 U. S. 561; *Lion Bonding Co.* v. *Karatz*, 262 U. S. 77. Such a surplus might occur, according to this contention, in one or more of the states, either because the deposits therein might exceed the total liabilities, or because the funds deposited to secure a certain form of contract might exceed the liabilities thereunder, [fol. 457] and in either case creditors whose claims have not been paid in full would be obliged to file claims in every state in which such a surplus might be found.

Again, we are asked to consider possibilities, without substantial showing, that such surpluses probably will be found in any state other than West Virginia. Moreover, these arguments relate primarily to the interests of creditors whose claims are not secured or are insufficiently secured by deposits in their respective states. The majority of these contract holders live in the states of Ohio, Pennsylvania and Virginia, which adjoin West Virginia. The claims of all of the unsecured contract holders must necessarily be filed in West Virginia for there only a substantial surplus will surely be found. It will be as convenient for creditors to file their claims in the state as in the federal court. It is true that the West Virginia receivers may not bring suits in other states to secure control of deposits there in excess of local needs; but if such surpluses exist, it may be assumed that they will not be improperly withheld. In the event of controversy, suits can be brought without great difficulty by ancillary receivers appointed by the courts of other states for the purpose.

It has not been and cannot be reasonably contended that the interests of the well secured creditors will be advanced by interfering with the state officials in the prompt liquidation and distribution of the securities in their hands. The liquidation in every state in which deposits were made will be subject to the supervision of established governmental departments, as well qualified for the business as the trustee in bankruptcy. There is every reason to believe that the liquidation under their supervision will proceed without needless expense in a careful and expeditious manner so as to save as much as possible for the contract holders. Certainly it would be unjust and unreasonable to delay the satisfaction of their claims in order that illusory hopes of reorganization may be entertained. That which serves the interest of this group will also be to the advantage of the creditors in such states as Illinois (liabilities $4,225,790.—[fols. 458-459] market value of securities $3,759,894), where the contracts are secured by a very substantial but insufficient deposit.

Moreover, it must be borne in mind that the rights of the contract holders in the several states must be determined in each instance by the local statutes, and that these statutes must be interpreted in accordance with the decisions of the state courts. It is no reflection upon the federal court to suggest that the state courts of the fifteen states are better qualified to construe and apply their own laws. Considerations of this kind were doubtless influential with Congress in excepting from the Bankruptcy Act those corporations, such as insurance, railroad and banking corporations, whose business during their active life and whose liquidation in case of insolvency are strictly regulated by state law. Indeed, in deciding that it is to the best interests of the creditors of the Fidelity that the proceeding in the state court of West Virginia be not superseded by the proceeding in bankruptcy, we are merely following the example set by Congress. See, *In the Matter of Poloma Estates, Inc.*, 2 Cir., 126 F. 2d 72.

The District Judge also referred in his opinion to the fact that one of the receivers appointed by the Circuit Court of Kanawha County, West Virginia, is a law partner of a director who served on the Board of the Fidelity for many years; and the suggestion is made that the state court receivers would not be likely to proceed diligently against the directors if an investigation should disclose the existence of

some liability on their part to the corporation's creditors. No specific facts are set out in this respect, but if such facts exist and the necessity for a proceeding against the directors should arise, we have no reason to suppose that the state court will not do its full duty in the premises.

Our conclusion is that the petition should be dismissed. The order of the District Court will be reversed and the case remanded for further proceedings consistent with this opinion.

*Reversed and Remanded.*

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[fol. 460] IN UNITED STATES CIRCUIT COURT OF APPEALS, FOURTH CIRCUIT

No. 4923

EDGAR B. SIMS, Auditor of the State of West Virginia, and Ex-Officio Insurance Commissioner of the State of West Virginia; Ross B. Thomas and H. Isaiah Smith, West Virginia State Court Receivers; Banking Commission of Wisconsin; Chas. R. Fischer, Commissioner of Insurance and Permanent Receiver for Debtor Corporation in and For the State of Iowa; John B. Gontrum, Insurance Commissioner of the State of Maryland; Dewey S. Godfrey, Missouri State Court Receiver; and L. H. Brooks, Trustee, Frederic Leake and A. L. Goldberg, Jr., Trustee, Appellants,

vs.

FIDELITY ASSURANCE ASSOCIATION, a Corporation, Debtor, Appellee

Appeal from the District Court of the United States for the Southern District of West Virginia

DECREE—Filed and Entered June 16, 1942

This Cause came on to be heard on the transcript of the record from the District Court of the United States for the Southern District of West Virginia, and was argued by counsel.

On Consideration Whereof, It is now here ordered, adjudged, and decreed by this Court that the decree of the said District Court appealed from, in this cause, be, and

the same is hereby, reversed with costs; and that this cause be, and the same is hereby, remanded to the District Court of the United States for the Southern District of West Virginia, at Charleston, with direction to dismiss the petition in accordance with the opinion of the Court filed herein.

June 16, 1942.

Morris A. Soper, U. S. Circuit Judge.

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[fol. 461] IN UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT

[Title omitted]

PETITION FOR REHEARING—Presented July 13, 1942

To the Honorable, the Judges of the United States Circuit Court of Appeals, Fourth Circuit:

Comes now Fidelity Assurance Association, a corporation, the Appellee in the above entitled cause, and presents [fol. 462] this, its petition for a rehearing of the above entitled cause, and in support thereof, respectfully shows:

1. It is respectfully represented and insisted that this Honorable Court erred in holding that appellee should be classified as an insurance company under the West Virginia law and was, therefore, not subject to the provisions of Chapter X of the Bankruptcy Act.

In concluding that appellee should be classified as an insurance company under the West Virginia law, this Honorable Court found that appellee after December 31, 1940, and prior to April 1, 1941, issued 9,802 contracts of insurance. This finding was based upon issuance of such number of so-called riders to certain annuity contracts issued by appellee prior to December 31, 1940, in connection with which the insurance undertakings were carried by the Lincoln National Life Insurance Company. After December 31, 1940, and until April 1, 1941, and thereafter, the Lincoln National Life Insurance Company continued to carry such insurance undertakings.

No evidence of the so-called riders was properly in the record. The order appealed from was entered by the District Court on the 5th day of January, 1942. No offer of

evidence relating to the so-called riders was made in the District Court.

The information pertaining to such so-called riders reached this Honorable Court through the petition of Edgar B. Sims, etc. et al., to this Honorable Court for a remand to the District Court for a rehearing thereon on the ground of newly discovered evidence, which petition was filed in this Honorable Court on the 20th day of April, 1942. This petition was filed after the time within which newly discovered evidence may be presented under Rule 595, Rules of Civil Procedure.

[fol. 463] In response to said petition to remand, appellee filed with this Honorable Court on April 20, 1942, the affidavit of F. J. McNulty to the purpose and effect that the insurance undertakings of such annuity certificates were never assumed by appellee, but were at all times carried by the Lincoln National Life Insurance Company and that appellee at no time engaged in any insurance business.

It is respectfully submitted that if this Honorable Court seriously considered the presentation of the petition for a remand to the District Court and the representations therein with reference to such so-called riders, the cause should be remanded to the District Court for the full development of the facts with respect to and attendant upon the issuance of such riders and a finding by the District Court on the facts and law applicable thereto.

It is respectfully submitted that the statement of facts relating thereto embodied in the order entered by this Honorable Court on April 20, 1942, did not constitute a full and complete development of the facts with respect thereto.

2. The enactment of the Securities Act of 1933, creating the Securities and Exchange Commission, and the various amendments and additions thereto, the revision of the Federal statutes relating to bankruptcy, including the enactment of Chapter X—Corporate Reorganizations, and the enactment of the Investment Company Act of 1940, manifest a distinct departure from the principles of public policy previously prevailing with respect to the supervision and regulation of the financial affairs of business organizations affected with a public interest and the establishment of a National public policy with respect thereto.

The Securities Act, and the amendments thereto, and the Investment Company Act subject businesses of the

[fol. 464] character involved in this cause to Federal supervision and regulation, and section 29 of the Investment Company Act of 1940 expressly recognizes that a face amount certificate company may be a "debtor" within the provisions of the Bankruptcy Act.

These comparatively recent congressional enactments would seem to eliminate the application of any principles formerly applied to businesses of a public or quasi-public nature of this character suggesting or requiring state supervision and regulation, to the exclusion of Federal supervision and regulation, and the introduction of Federal supervision and regulation.

The Securities Act, with the amendments and the additions thereto, and the Investment Company Act have provided the Federal supervision and regulation, while Chapter X of the Bankruptcy Act, and the Investment Company Act of 1940, have provided, through the bankruptcy courts, the facilities for the reorganization of businesses of the character involved in this cause.

The high purposes of said acts, the Securities Act, the Investment Company Act and the Corporate Reorganization Act, will be largely defeated if the charter powers, as distinguished from the business actually transacted, be considered the criterion in determining what corporations are within the operation of said Chapter X—Corporate Reorganizations, suggesting the necessity that the exceptions therefrom be strictly construed, if the public is to derive the full benefits contemplated by such acts.

Wherefore, upon the foregoing grounds, it is respectfully urged that this petition for rehearing be granted and that the judgment of the United States District Court for the Southern District of West Virginia be, upon further consideration, affirmed or the cause be remanded to the United States District Court for the Southern District [fol. 465] of West Virginia for a full and complete presentation and development of the facts relating to the issuance of the so-called riders and for said District Court to make its proper findings of fact and conclusions of law with reference thereto.

Respectfully submitted, James R. Fleming, John V. Ray, Homer A. Holt, Counsel for Appellee.

[fol. 466] CERTIFICATE OF COUNSEL

We, John V. Ray and Homer A. Holt, counsel for the above named Fidelity Assurance Association, Appellee, do hereby certify that the foregoing petition for a rehearing of this cause is presented in good faith and not for delay.

John V. Ray, Homer A. Holt, Counsel for Fidelity Assurance Association.

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[fol. 467] IN UNITED STATES CIRCUIT COURT OF APPEALS

ORDER STAYING MANDATE PENDING PETITION FOR REHEARING—Filed July 14, 1942

Upon the Application of Fidelity Assurance Association by its counsel Homer A. Holt and John V. Ray, and for good cause shown,

It Is Ordered that the mandate of this Court in the above entitled cause be, and the same is hereby, stayed pending the action of this Court upon the petition for rehearing this day filed by Fidelity Assurance Association.

July 13, 1942.

John J. Parker, Senior Circuit Judge.

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IN UNITED STATES CIRCUIT COURT OF APPEALS, FOURTH CIRCUIT

[Title omitted]

ORDER DENYING REHEARING—Filed and Entered July 22, 1942

This Court having at its June term, 1942, rendered its decision reversing the order of the said District Court appealed from in this cause, and the appellee having on July 13, 1942, presented to the Court a petition for a rehearing of the said cause, and the same having been carefully considered,

[fol. 468] It Is Now Here Ordered by This Court that the rehearing asked for be, and the same is hereby, denied.

John J. Parker, Senior Circuit Judge. Morris A. Soper, U. S. Circuit Judge. Armistead M. Dobie, U. S. Circuit Judge.

## In United States Circuit Court of Appeals

### Order Staying Mandate Pending Application for Writ of Certiorari—Filed and Entered July 22, 1942

Upon the Application of Fidelity Assurance Association by its counsel Homer A. Holt and John V. Ray, and Central Trust Company, Trustee for Fidelity Assurance Association, by its counsel T. C. Townsend and Hillis Townsend, and for good cause shown,

It Is Ordered that the mandate of this Court in the above entitled cause be, and the same is hereby, stayed pending the application of the said Fidelity Assurance Association and the said Central Trust Company, Trustee for Fidelity Assurance Association, in the Supreme Court of the United States for a writ of certiorari to this Court, unless otherwise ordered by this or the said Supreme Court, and provided said application is filed in the said Supreme Court within 30 days from this date.

It Is Further Ordered that the order of the United States District Court for the Southern District of West Virginia entered on August 9, 1941 be and hereby is modified as follows:

1. All cash, securities and other property heretofore deposited by Fidelity Assurance Association with various state officials and now in the possession and custody of state officials or receivers may be sold, invested, re-invested or kept uninvested as may be directed by state courts or [fol. 469] state officials having control, supervision, or jurisdiction over said funds. Any state official or receiver making any change in investments pursuant to the provisions of this order shall give prompt notice thereof to the Central Trust Company, Trustee for Fidelity Assurance Association, but such notice shall be without prejudice and shall not be considered as a consent to the jurisdiction of the District Court of the United States for the Southern District of West Virginia, or of this Court, or as a waiver of any right or immunity asserted by such state official or receiver.

2. All cash, securities and other property now in the possession or custody of Central Trust Company, Trustee for Fidelity Assurance Association, may be sold, invested, re-

invested or kept uninvested as may be directed by the United States District Court for the Southern District of West Virginia.

3. All costs, expenses of counsel and other necessary expenses, including expenses of administration and of state court proceedings, but not including compensation for counsel or receivers, heretofore or hereafter incurred by or on behalf of state officials or receivers having possession or custody of cash, securities or other property deposited by Fidelity Assurance Association with state officials or heretofore or hereafter incurred by or on behalf of the parties appellant in this proceeding, may be paid out of the respective funds in the possession or custody of such state officials and receivers, such costs and expenses to be in such amounts as may be allowed by the state courts or state administrative officials having control, supervision, or jurisdiction over said funds.

4. All costs, expenses of counsel for Fidelity Assurance Association and counsel for Central Trust Company, Trustee for Fidelity Assurance Corporation, and other necessary expenses, including expenses of administration, but [fol. 470] not including compensation for counsel for Fidelity Assurance Association or Central Trust Company, Trustee for Fidelity Association, or compensation to Central Trust Company, Trustee, heretofore or hereafter incurred by or on behalf of said Debtor or its Trustee, or heretofore or hereafter incurred by or on behalf of the Debtor or its Trustee in this proceeding, may be paid out of the funds in the possession or custody of Central Trust Company, Trustee for Fidelity Assurance Association, such costs and expenses to be in such amounts as may be allowed by the United States District Court for the Southern District of West Virginia.

5. The Central Trust Company, Trustee of Fidelity Assurance Association, shall proceed as promptly as possible to compile and prepare lists of those persons holding contracts of the Debtor, on which there was a reserve value as of April 11, 1941, or which were not delinquent on that date. There shall be a separate list for each state in which contract holders resided, and such lists shall show the contract number, the date thereof, and face amount, the payments made

thereon, cash surrender value, reserve value and any net loan thereon, and the name and address of the contract holder. A copy of such list shall be furnished to any official of the state covered thereby or to any other person designated by a proper court of such state.

6. Each state court or state official having jurisdiction, supervision or control of cash, securities or other property deposited by Fidelity Assurance Association, may proceed to give notice to the contract holders, accept proof of claims, begin and continue necessary administrative work looking towards the future distribution of said funds, except that [fol. 471] no distribution shall be made to contract holders or other creditors.

John J. Parker, United States Circuit Judge, Fourth Circuit. Morris A. Soper, United States Circuit Judge, Fourth Circuit. Armistead M. Dobie, United States Circuit Judge, Fourth Circuit.

———, 1942.

The Central Trust Company, Trustee, Fidelity Assurance Association, Debtor, by counsel, and counsel for the West Virginia, Maryland and Tennessee appellants, acting for and on behalf of all appellants in so far as they are authorized, hereby consent to the conditions to the stay of mandate herein, as above set forth, without any of said parties in any way waiving any of their objections heretofore made, and without consenting to any jurisdiction over them not heretofore acquired, and without waiving any rights or immunities now existing in their favor or behalf.

John V. Ray, Homer A. Holt, Attorneys for Fidelity Assurance Ass'n. Hillis Townsend, Attorney for Central Trust Company, Trustee, etc. J. Campbell Palmer, III, Attorney for West Virginia Appellants. H. Vernon Eney, Attorney for Maryland Appellants. Fyke Farmer, Attorney for Tennessee Appellants.

July 22, 1942, certified copy of order staying mandate is transmitted to the Clerk of the District Court at Charleston, West Virginia.

[fol. 472] IN UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT

[Title omitted]

MOTION OF APPELLEE FOR MODIFICATION OF ORDER OF JULY 22, 1942—Filed August 8, 1942

To the Honorable, The Judges of The United States Circuit Court of Appeals, Fourth Circuit:

Comes now Fidelity Assurance Association, a corporation, the Appellee in the above entitled cause, and moves that the order entered herein on July 22, 1942 be modified to the extent necessary to preserve the assets deposited by Fidelity Assurance Association with various state officials and now in the possession and custody of state officials or receivers in the form in which they now are except when sale, exchange, investment or reinvestment of a part thereof [fol. 473] is required in order to prevent loss to the estate of Fidelity Assurance Association pending the stay of the mandate of this Court, and that any such sale be made only on the recommendation of a recognized investment counsellor.

In support of said motion the said Fidelity Assurance Association says that at the informal hearing in Charlotte, North Carolina, on July 13, 1942 on the application for stay of mandate counsel representing Edgar B. Sims, Auditor etc. stated that a few days prior thereto a meeting of the representatives of the various state officials and receivers who had possession of said deposits had been held in Charleston, West Virginia, and at said meeting it had been agreed that those holding the deposited securities would not sell them during the pendency of this case in the United States Supreme Court, and that if the decision of the Circuit Court of Appeals for the Fourth Circuit is sustained, another meeting of said representatives would be held at which plans for the sale of such securities in the most advantageous manner would be considered.

At said hearing, and in opposing a stay of mandate without a large bond, counsel for John B. Gontrum, Insurance Commissioner, stated that the injunction order entered by the United States District Court for the Southern District of West Virginia on August 9, 1941 should be modified so

as to permit the state officials and receivers having securities of Fidelity Assurance Association in their possession to sell any issues in which serious losses were threatened, to invest cash on hand and to reinvest the proceeds of any sales; and counsel for Fidelity Assurance Association stated he thought that orders entered by the District Judge were [fol. 474] sufficient therefor, but if they were not, he was of opinion that the estate of Fidelity Assurance Association should be preserved and protected by proper management of the securities, and if modification of the said order of August 9, 1941 was necessary therefor he was not opposed to it.

In the conference of attorneys present at the said hearing which was held in the afternoon counsel for Fidelity Assurance Association consented to the order which was later entered on July 22, 1942 in the belief that the object of the modification of the said order of August 9, 1941 was solely to permit the sale of a security to prevent an impending loss.

In considering the said order of July 22, 1942, with representatives of the Appellee and the Trustee, it became apparent that to those who did not have the benefit of the informal conference at Charlotte on July 13, 1942, the order of July 22, 1942 was not entirely clear and too broad in modifying the order of August 9, 1941, so that persons not familiar with the informal conference at Charlotte on July 13th might possibly interpret the order as authorizing a sale for liquidation rather than for conservation alone.

Counsel for Fidelity Assurance Association at once consulted counsel for Edgar B. Sims, Auditor etc. and requested that the proposed order be modified, and said counsel stated that he would have no objection to the following modification, to-wit, that the following words be inserted at the end of the first sentence of Paragraph 1, viz., "for the purpose of preserving and protecting the said deposits, but this order shall not be construed to authorize the sale and conversion of any securities into cash for the sole purpose of liquidation, and no sale of securities shall be made except for the purpose of preventing loss to the estate of Fidelity Assurance Association pending the stay of mandate." [fol. 475] The said counsel for Edgar B. Sims, Auditor etc. agreed to submit the proposed modification to counsel representing the other Appellants, and pending an answer from him the order of July 22, 1942 was entered. Counsel

for Fidelity Assurance Association were under the impression that the said order would not be entered until an application in writing for stay of mandate was filed in this court, which they intended to file if the petition for rehearing was denied, and did not advise this court of their request for a modification of the proposed consent order other than by a letter to Judge Parker dated July 18, 1942, a copy of which is attached hereto, marked "Exhibit 1".

Counsel for other appellants have refused to consent to the suggested modification, as will fully appear from the following letters attached hereto as a part hereof:

Letter from John V. Ray to J. Campbell Palmer, III, dated July 17, 1942, marked "Exhibit 2."

Letter from J. Campbell Palmer, III to John V. Ray, dated July 20, 1942, marked "Exhibit 3."

Letter from John V. Ray to J. Campbell Palmer, III, dated July 20, 1942, marked "Exhibit 4."

Letter from John V. Ray to J. Campbell Palmer, III, dated July 21, 1942, marked "Exhibit 5."

Letter from J. Campbell Palmer, III to Judge Parker, dated July 22, 1942, marked "Exhibit 6."

Letter from H. Vernon Eney to John V. Ray, dated July 22, 1942, marked "Exhibit 7."

Letter from Ben C. Buckingham to J. Campbell Palmer, III, dated July 25, 1942, marked "Exhibits 8."

Letter from Judge Parker to John V. Ray and J. Campbell Palmer, III, dated July 27, 1942, marked "Exhibit 9."

Letter from J. Campbell Palmer, III to Judge Parker, dated August 1, 1942, marked "Exhibit 10."

[fol. 476] Counsel for Fidelity Assurance Association submit that the assets of Fidelity Assurance Association should be preserved during the stay of mandate in the form in which they now are unless it is necessary to change investments in order to prevent serious loss, which changes of investment should be made only on the recommendation of recognized investment counsellors; and that in order to guarantee such preservation of assets in their present form, as appears from the annexed letters, it will be necessary to restrict the modification of the injunction order of August

9, 1942 by an order of this Court which will modify the order entered by it on July 22, 1942.

John V. Ray, Homer A. Holt, Attorneys for Fidelity Assurance Association. Address: Kanawha Valley Building, Charleston, West Virginia.

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[fol. 477] EXHIBIT 1

July 18, 1942.

Hon. John J. Parker, U. S. Circuit Judge, Charlotte, North Carolina.

In re: Sims, Auditor etc. vs. Fidelity Assurance Association

Dear Judge Parker:

At the conference in your office on Monday, Mr. Palmer stated that representatives of the states in which deposits made by Fidelity Assurance Association are held had met and agreed that there would be no sale and conversion into cash of the securities of Fidelity Assurance Association pending any proceedings in the Supreme Court of the United States.

In the proposed Order to be entered staying the mandate, in the paragraph numbered one, we intended to authorize, those having custody of the deposits to make such sales, investments and re-investments as might be necessary to avoid losses during the pendency of such proceedings.

On reviewing the proposed Order, however, I have come to the conclusion that the authority to sell securities is now too broad, and I have discussed with Mr. J. Campbell Palmer, III a modification of the paragraph numbered one which will give effect to what I believe was the true intention of all of us who worked on the consent order.

The change I have suggested is satisfactory to Mr. Palmer, and he is going to consult his associates about it. I am enclosing a carbon copy of the letter I have written Mr. Palmer on the subject, and I trust that within the next few days Mr. Palmer and I will be able to write you on behalf of all the parties interested that the suggested change has been agreed to.

Very truly yours, (S.) John V. Ray.

Enc.
JVR:MLB.

[fol. 478] EXHIBIT 2

July 17, 1942.

Mr. J. Campbell Palmer, III, c/o Koontz & Koontz, Union Building, Charleston, West Virginia.

In re: Case No. 4923. Sims, Auditor, etc. vs. Fidelity Assurance Association

DEAR MR. PALMER:

As I told you at our conference this morning, I think Paragraph 1 of the proposed Order to stay the mandate should be amended so as to provide that sales of securities pursuant thereto shall be limited to sales necessary to protect the estate.

You will recall that in the conference with Judge Parker at Charlotte, you stated that the representatives of states in which there are deposits had agreed that there would be no sale and conversion into cash of the securities deposited pending the proceedings in the Supreme Court of the United States. I think such a restriction should be in the Order staying the mandate, so I am writing to ask you that you and your associates join me in a letter to Judge Parker requesting that Paragraph 1 of the proposed Order be modified.

After further consideration of the change which you and I discussed and tentatively agreed upon this morning, I have come to the conclusion that it will accomplish what I have in mind. I suggest that the following words be inserted at the end of the first sentence of Paragraph 1, viz., "for the purpose of preserving and protecting the said deposits, but this order shall not be construed to authorize the sale and conversion of any securities into cash for the sole purpose of liquidation, and no sale of securities shall be made except for the purpose of preventing loss to the estate of Fidelity Assurance Association pending the stay of mandate."

[fol. 479] It may be well to set out Paragraph 1 as it would be as so amended:

1. All cash, securities and other property heretofore deposited by Fidelity Assurance Association with various state officials and now in the possession and custody of state officials or receivers may be sold, invested, re-invested or kept uninvested as may be directed by state courts or

state officials having control, supervision, or jurisdiction over said funds for the purpose of preserving and protecting the said deposits, but this order shall not be construed to authorize the sale and conversion of any securities into cash for the sole purpose of liquidation, and no sale of securities shall be made except for the purpose of preventing loss to the estate of Fidelity Assurance Association pending the stay of mandate.

I am sending you five carbon copies of this letter for your convenience in submitting the proposed change to Messrs. Eney, Farmer and the others.

I suggest that you request them to authorize you to join me in a letter to Judge Parker, which will ask that the proposed Order be so amended.

Very truly yours, (S.) John V. Ray.

JVR:MLB

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[fol. 480] EXHIBIT 3

(Letterhead of Koontz & Koontz)

July 20, 1942.

Mr. John V. Ray, Kanawha Valley Building, Charleston, West Virginia.

Re: Sims vs. Fidelity Assurance Association. Case No. 4923

DEAR JOHN:

I am returning to you the letters you sent me because the first sentence of your second paragraph is not strictly correct. I stated at the conference in Charlotte that which the conference in Charleston had agreed to, and read you my letter to the conference members, which stated, in part: "* * * in that the funds are not to be immediately sold by any states, but only where there is a necessity for selling the deposited securities which may, or appear to be depreciating in value, or where there is a real opportunity for sale which might not soon again occur. All of us have agreed that we will be cautious in making any sales pending our later conference—after disposing of the matter in the United States Supreme Court, ——."

This is the substance of what I told Judge Parker and what I spoke to you about, and I believe it should be pre-

sented in somewhat similar fashion rather than that I stated that "there would be no sale and conversion into cash of the securities deposited pending the proceedings in the Supreme Court of the United States."

I again say that I have no objection to the amendment as you have stated it, although I really cannot see where it will add anything, but will be glad to communicate it to the appellants.

Very sincerely, Koontz & Koontz, by (S.) J. Campbell Palmer, III.

JCP:H
Enclosure

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[fol. 481] EXHIBIT 4

July 20, 1942.

Mr. J. Campbell Palmer, III, c/o Koontz & Koontz, Union Building, Charleston, West Virginia.

In re: Case No. 4923, Sims, Auditor etc. vs. Fidelity Assurance Association

DEAR MR. PALMER:

As I told you at our conference on July 17th, I think Paragraph 1 of the proposed Order to stay the mandate should be amended so as to provide that sales of securities pursuant thereto shall be limited to sales necessary to protect the estate.

From the statements made by you and your associates in the conference with Judge Parker at Charlotte, I am under the impression that it is not the intention of those holding these deposited securities to make a sale of all of them and convert them into cash pending the proceedings in the Supreme Court of the United States, but I think a restriction against such sale and conversion should be in the Order staying the mandate, so I am writing to ask that you and your associates join me in a letter to Judge Parker requesting that Paragraph 1 of the proposed Order be modified.

After further consideration of the change which you and I discussed and tentatively agreed upon on July 17th, I have come to the conclusion that it will accomplish what I have in mind. I suggest that the following words be inserted at the end of the first sentence of Paragraph 1, viz.,

"for purpose of preserving and protecting the said deposits, but this order shall not be construed to authorize the sale and conversion of any securities into cash for the sole purpose of liquidation, and no sale of securities shall be made except for the purpose of preventing loss to the estate of Fidelity Assurance Association pending the stay of mandate."

[fol. 482] It may be well to set out Paragraph 1 as it would be as so amended:

1. All cash, securities and other property heretofore deposited by Fidelity Assurance Association with various state officials and now in the possession and custody of state officials or receivers may be sold, invested, re-invested or kept uninvested as may be directed by state courts or state officials having control, supervision, or jurisdiction over said funds for the purpose of preserving and protecting the said deposits, but this order shall not be construed to authorize the sale and conversion of any securities into cash for the sole purpose of liquidation, and no sale of securities shall be made except for the purpose of preventing loss to the estate of Fidelity Assurance Association pending the stay of mandate.

I am sending you five carbon copies of this letter for your convenience in submitting the proposed change to Messrs. Eney, Farmer and the others.

I suggest that you request them to authorize you to join me in a letter to Judge Parker, which will ask that the proposed Order be so amended.

Very truly yours, (S.) John V. Ray.

JVR:MLB

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[fol. 483] EXHIBIT 5

July 21, 1942.

Mr. J. Campbell Palmer, III, c/o Koontz & Koontz, Union Building, Charleston, West Virginia.

In re: Sims, Auditor etc. vs. Fidelity Assurance Association, Case No. 4923

DEAR MR. PALMER:

I acknowledge receipt of your letter of July 20th, with which you returned to me the letter I wrote you on July 17th and the copies thereof.

The second paragraph of my letter of July 17th states my recollection of the statements made to Judge Parker by you and your associates. However, I see no reason why we should engage in any controversy as to what was said or what was not said on that occasion, because it was not my intention to agree that the Order of August 9th be modified so as to permit a sale of all the securities, and my object now is to get the proposed Order staying the mandate in that form.

I have, therefore, re-written the letter of July 17th, and enclose it to you herewith, dated July 20th.

Please do what you deem best to get authority from your associates to join me in a letter to Judge Parker requesting that the proposed modification be inserted in the consent Order.

Very truly yours, (S.) John V. Ray.

JVR:MLB
Encl.

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[fol. 484] EXHIBIT 6

July 22, 1942.

Hon. John J. Parker, Judge, United States Circuit Court of Appeals, Fourth Circuit, Charlotte, North Carolina.

In re: Sims, Auditor, etc., vs. Fidelity Assurance Association

DEAR JUDGE PARKER:

I have a copy of Mr. John Ray's letter of July 18, 1942, to you, and am writing this in order to keep the record straight. I thought I said at the conference with you, and fully intended to say if I did not make it clear, that at the conference of the fifteen states held in Charleston prior to the conference with you, it was agreed amongst us that there would be no sale of assets made merely for the purpose of liquidation, but if there appeared to be a loss through market depreciation or other reasons, or if it appeared that an offer to sell was extremely good and not likely to be available again in the near future, that each state would be permitted to exercise its own judgment in making sales in that regard.

Mr. Ray conferred with me concerning the proposed change in the order, and I advised him that I could see that

it would add nothing to the order, but since he so earnestly desired it, I had no objection thereto on behalf of our clients, but could not attempt to speak for the other appellants in the case. They have been notified by me of the conversation with Mr. Ray and if they have no objections to the change, you will be so notified.

I trust that this will make the matter entirely clear.

Very sincerely, Koontz & Koontz, (S.) by J. Campbell Palmer, III.

JCP:H.

CC: Mr. John V. Ray, Mr. Rickard H. Lauritzen, Mr. Fyke Farmer, Mr. Vernon Eney, Mr. Rudolph K. Schurr, Mr. Ben C. Buckingham, Hon. W. S. Wysong.

[fol. 485] EXHIBIT 7

(Letterhead of Armstrong, Machen, Allen & Eney, Attorneys and Counsellors at Law)

Baltimore, Maryland,
July 22, 1942

John V. Ray, Esq., Kanawha Valley Building, Charleston, West Virginia.

*In re: Fidelity Assurance Association*

DEAR MR. RAY:

I have just received a letter from Mr. Palmer in which he states that you saw him on last Friday and indicated that you were disturbed for fear that some of the states might liquidate their deposits immediately. Mr. Palmer has asked whether we would be willing to agree to a modification of the proposed order prepared in Charlotte on Monday of last week by inserting the following words at the end of the first sentence of paragraph 1 of the order:

"for the purpose of preserving and protecting said deposits, but this order shall not be construed to authorize the sale and conversion of any securities into cash for the sole purpose of liquidation, and no sale of securities shall be made except for the purpose of preventing loss to the estate of Fidelity Assurance Association pending the stay of mandate."

I can, of course, speak only for the Insurance Commissioner of Maryland, but on his behalf I would not be willing

to agree to the suggested change. I realize that the order prepared at Charlotte last week would authorize the liquidation by the various states of the deposited securities but I thought that all of us fully understood that this was the situation. It was certainly my understanding that the various states could proceed with liquidation of the assets and all administrative work looking towards the ultimate liquidation and distribution of the assets of Fidelity except only that no actual distribution to contract holders would be made while the Federal suit is still pending. In other words, I understood that in effect the injunction order of [fol. 486] August 9, 1941, was now limited to an injunction against distribution of the assets. This is borne out by paragraph 6 of the order left with Judge Parker last week.

Entirely apart from the fact that the suggested modification is a departure from what was agreed to last week, I would object to the same because of the difficulty in ascertaining at any particular time whether a sale is necessary in order to prevent loss. Who is to decide this question? Our theory in Maryland is that all of the assets should be liquidated promptly in order to prevent loss which may result from a decline in market values. We, of course, do not know what the situation will be six months or a year from now, but we do feel very strongly that since liquidation is inevitable, it should be accomplished promptly. I think I expressed these ideas as forcibly as possible at the hearing before Judge Parker last week.

I do not mean to indicate by what has been said above that the Maryland officials plan to dispose of their securities at once. We have no intention of dumping our securities on the market but on the contrary, expect to work out mutually satisfactory arrangements with other interested state officials to dispose of the securities as advantageously as possible. This will take time but we do not want to be hampered in these efforts by the indefinite language suggested in Mr. Palmer's letter which would possibly throw upon us an impossible burden of showing an actual impending loss before we could proceed with the sale of securities.

I am sending a copy of this letter to the other interested parties so that they may understand our position.

Very truly yours, (S.) H. Vernon Eney.

HVE/PS.
6582.

C.C. J. Campbell Palmer, III, Esq., Rudolph K. Schurr, Esq., Ben C. Buckingham, Esq., W. F. Gray, Esq., Dale Dunifon, Esq., Hardie Scott, Esq., George W. Bramer, Esq., Charles L. Rowe, Esq., Fyke Farmer, Esq., Richard H. Lauritzen, Esq., Earl B. Swarner, Esq., Thomas Heriihy, Jr., Esq., Blake T. Newton, Jr., Esq., J. W. Jones, Esq., W. S. Wysong, Esq.

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[fol. 487] EXHIBIT 8

July 25, 1942.

Mr. J. Campbell Palmer, III., c/o Koontz & Koontz, Attorneys at Law, Union Building, Charleston, West Virginia.

*Re: Fidelity Assurance Association*

DEAR CAM:

The writer has received your letter relative to suggested change in the order to be signed by Judge Parker, and has also received letter from John V. Ray relative to the same subject matter.

It was the writer's understanding at our conference in Charleston, West Virginia, that we were to be able to do all things necessary towards liquidation but we were not to pay the claims of creditors pending the debtor corporation's appeal to the Supreme Court of the United States.

It was our specific understanding that we were to be able to sell any and all securities held and that we were to wait a reasonable time for the Sims committee to see if it could work out a sale of all the assets more advantageously than the same could be sold in individual blocks.

Were we to agree to John Ray's suggested amendment to the order this would tie our hands to the point where we are practically at the present time. Therefore, it is the writer's opinion and conclusion that we cannot agree to such an amendment and will resist the same if Mr. Ray insists that this order be amended.

For us to go further into detail would be merely repeating some of the reasons set forth in Vernon Eney's letter, which, you no doubt have.

Iowa, as agreed at the conference, does not intend to step out of bounds on the liquidation but will go along with the

rest of the states in order that the best interests of all may be attained.

Very truly yours, (S.) Ben C. Buckingham.

BCB:L.

CC—Farmer, Ray, Lauritzen, Schurr.

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[fol. 488] EXHIBIT 9

UNITED STATES CIRCUIT COURT OF APPEALS, FOURTH JUDICIAL CIRCUIT

Chambers of John J. Parker, U. S. Circuit Judge,
Charlotte, N. C.

July 27, 1942.

Mr. John V. Ray, Attorney at Law, Charleston, W. Va.
Mr. J. Campbell Palmer, III, Attorney at Law, Charleston, W. Va.

*Re: Sims* v. *Fidelity Assur. Ass'n, No. 4923*

GENTLEMEN:

Your letters of recent date were received at my office while I was away on vacation. They were forwarded to me, but the orders denying rehearing and staying mandate pending application for certiorari had always been entered. If you think that the order as entered should be modified as suggested in Mr. Ray's letter, please prepare and submit order to me.

With kind regards, I am

Sincerely yours, (S.) John J. Parker
B

JJP/B.

[fol. 489] EXHIBIT 10

August 1, 1942,

Hon. John J. Parker, Judge, United States Circuit Court of Appeals, Fourth Judicial Circuit, Charlotte, North Carolina.

*Re: Sims et al. vs. Fidelity Assurance Association Case No. 4923*

DEAR SIR:

I am perfectly satisfied with the order as agreed to by all counsel and as entered by the Court. Mr. Ray, not being satisfied, brought the matter to my attention, and I had personnally no objections to the change. However, Mr. Eney of Maryland, Mr. Schurr of Missouri, Mr. Buckingham of Iowa, Mr. Lauritzen of Wisconsin, and Mr. Farmer of Tennessee, whom I notified of Mr. Ray's ideas of the proposed change, have written me that they are vigorously opposed to any such change and would like to be heard before the Court before any such change were made, if the Court felt it so advisable.

Therefore, while West Virginia has no objections to such change in the order, the other appellants each and all have objections thereto, and it is my thought that since the amendment would add nothing to that which is already in the order, we would be wasting the Court's as well as counsel's time in doing anything further in the matter.

Very sincerely, Koontz & Koontz, (S.) by J. Campbell Palmer, III.

JCP:H.

CC: Mr. John V. Ray, Mr. Rickard H. Lauritzen, Mr. Fyke Farmer, Mr. H. Vernon Eney, Mr. Rudolph K. Schurr, Mr. Ben C. Buckingham, Hon. W. S. Wysong.

[fol. 490] IN UNITED STATES CIRCUIT COURT OF APPEALS, FOURTH CIRCUIT

[Title omitted]

ORDER DIRECTING CLERK TO FILE MOTION TO BE CONSIDERED BY THE COURT AFTER NOTICE HAS BEEN DULY GIVEN TO COUNSEL OF RECORD—Filed August 8, 1942

Counsel for Fidelity Assurance Association having this day filed with the undersigned the attached motion; and it appearing that the motion is one which cannot be acted upon by the Senior Circuit Judge alone, but would have to be considered by the Circuit Court of Appeals:

It is ordered that the Clerk of the Circuit Court of Appeals file said motion to be considered by the Court after notice has been duly given to counsel of record. The motion will not be considered by the Court until its next term unless request therefor is specifically made.

Done at Charlotte, North Carolina, this the 7th day of August, 1942.

John J. Parker, Senior Circuit Judge.

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[fol. 491] IN UNITED STATES CIRCUIT COURT OF APPEALS

ORDER AUTHORIZING CLERK TO USE ORIGINAL TRANSCRIPT OF RECORD IN MAKING UP RECORD FOR USE IN THE SUPREME COURT OF THE UNITED STATES ON APPLICATION FOR WRIT OF CERTIORARI

For Reasons Appearing to the Court,

It is ordered that the Clerk of this Court, in making up certified transcripts of records for use in the Supreme Court of the United States on applications for writs of certiorari to this Court, be, and he is hereby, authorized to use and incorporate therein the originial transcripts of records filed in this Court. The said original transcripts of records shall be returned to this Court after the cases are finally disposed of in the said Supreme Court.

Further ordered that a copy of this order be incorporated in said certified transcripts of records.

January 9th, 1941.

John J. Parker, Senior Circuit Judge.

[fols. 492-494] Clerk's Certificate to foregoing transcript omitted in printing.

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[fol. 495] SUPREME COURT OF THE UNITED STATES

[Title omitted]

ORDER ALLOWING CERTIORARI—Filed October 12, 1942

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Fourth Circuit is granted.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

Mr. Justice Douglas took no part in the consideration or decision of this application.

CLERK'S COPY.

# Vol. II

## TRANSCRIPT OF RECORD

## Supreme Court of the United States

**OCTOBER TERM, 1942**

## No. 319

FIDELITY ASSURANCE ASSOCIATION, A CORPORATION, DEBTOR, AND CENTRAL TRUST COMPANY, TRUSTEE FOR FIDELITY ASSURANCE ASSOCIATION, PETITIONERS,

*vs.*

EDGAR B. SIMS, AUDITOR OF THE STATE OF WEST VIRGINIA, AND EX-OFFICIO INSURANCE COMMISSIONER OF THE STATE OF WEST VIRGINIA, ET AL.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT

**PETITION FOR CERTIORARI FILED AUGUST 20, 1942.**

**CERTIORARI GRANTED OCTOBER 12, 1942.**

# SUPREME COURT OF THE UNITED STATES

## OCTOBER TERM, 1942

# No. 319

FIDELITY ASSURANCE ASSOCIATION, A CORPORATION, DEBTOR, AND CENTRAL TRUST COMPANY, TRUSTEE FOR FIDELITY ASSURANCE ASSOCIATION, PETITIONERS,

*vs.*

EDGAR B. SIMS, AUDITOR OF THE STATE OF WEST VIRGINIA, AND EX-OFFICIO INSURANCE COMMISSIONER OF THE STATE OF WEST VIRGINIA, ET AL.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT

## VOL. II

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[fol. 1] IN DISTRICT COURT OF THE UNITED STATES FOR THE SOUTHERN DISTRICT OF WEST VIRGINIA, AT CHARLESTON

In the Matter of FIDELITY ASSURANCE ASSOCIATION, Debtor

Proceedings for Corporate Reorganization, No. 4514

**Statement of Evidence**—Filed September 15, 1941

Before Honorable Ben Moore, United States District Judge, on Tuesday, the 5th day of August, 1941

APPEARANCES

Messrs. Townsend & Townsend (Mr. T. C. Townsend and Mr. Hillis Townsend), Charleston, West Virginia, Counsel for Central Trust Company, Trustee.

Mr. James R. Fleming, Fort Wayne, Indiana, Counsel for the Debtor.

Messrs. Justin N. Reinhardt, Edward C. Jaegerman and John P. Moore, Washington, D. C., Counsel for the Securities and Exchange Commission.

Mr. Allen H. Blondy, Detroit, Michigan, Counsel for Contract Holders Paul V. Lundstedt and Lelia Lundstedt.

[fol. 2] Mr. Austin V. Wood, Wheeling, West Virginia, Counsel for Edward W. Driehorst; H. C. Ogden, Trustee for Frances Ogden Stubblefield; H. C. Ogden, Trustee for Margaret Lawson Stubblefield; Charles E. Bates, Trustee for Eugenia G. Bates; Ohio Valley Lithographing Company; Mary V. Nager; Mrs. A. L. Jones; Edward C. Jepson; George C. Dannenberg and George S. Kender, all of whom are face-amount certificate holders and appear in their representative capacity representing all those similarly situated;

Mr. Raymond Huwe and Mr. John J. Rivers, Cincinnati, Ohio, Counsel for A. Clyde Ross, Trustee for Dorothy E. Ross, and A. Clyde Ross, Trustee for Shirley J. Ross of Cincinnati, Ohio; and Benjamin M. Ross of Fort Wright, Kentucky, on behalf of their trust and themselves and all others similarly situated;

Mr. Rudolph K. Schurr, St. Louis, Missouri, Counsel for Dewey S. Godfrey, Receiver for the Missouri policy holders.

Mr. Rickard H. Lauritzen, Madison, Wisconsin, Counsel for the Banking Commission of the State of Wisconsin and representing Charles R. Fisher, Commissioner of Insurance and Permanent Receiver in and for the State of Iowa.

Mr. Edmund Burke, Springfield, Illinois, Counsel for S. Leigh Call, Receiver in Illinois.

Mr. W. F. Gray, Springfield, Illinois, Assistant Attorney General, State of Illinois, representing the Secretary of State and the Treasurer of the State of Illinois.

Mr. Dorr E. Warner, Cleveland, Ohio, Counsel for Bertha Thornton, Victor H. Salkeld and G. W. Allen, contract holders.

Mr. Earl B. Swarner, Kansas City, Kansas, Counsel for V. M. Huffman, Securities Commissioner of the State of Kansas.

[fols. 3-23] Mr. Dale Dunifon, First Assistant Attorney General, Mr. David M. Spriggs and Howard Bernstein, Assistant Attorneys General, Columbus, Ohio, Counsel for the Treasurer of the State of Ohio

Mr. Fyke Farmer, Nashville, Tennessee, Counsel for L. H. Brocks, A. L. Goldberg, Jr., and Frederick Leake, contract holders.

Messrs. Price, Smith & Spilman (Robert S. Spilman, Jr.), Charleston, West Virginia, Counsel for George Melcher, R. E. McDonald, W. W. Fuller, C. E. Sanders and Lee Reeder, Protective Committee of the Missouri contract holders.

Mr. Clarence W. Meadows, Charleston, West Virginia, Attorney General of the State of West Virginia, Counsel for Edgar B. Sims, State Auditor and Ex Officio Insurance Commissioner of the State of West Virginia.

Mr. Ross B. Thomas, Charleston, West Virginia, Counsel for H. Isaiah Smith and Ross B. Thomas, Receivers of the Debtor, appointed by the Circuit Court of Kanawha County, West Virginia.

Messrs. Koontz & Koontz (J. Campbell Palmer III), Charleston, West Virginia, Counsel for H. Isaiah Smith and Ross B. Thomas, State Court Receivers of Fidelity Assurance Association.

. . . . . .

[fols. 24-39] STATEMENT RE OBJECTIONS

The Court: Now before we proceed with this other matter we have mentioned, I notice that Section 162 of the act

provides that the court may at this hearing hear objections to the retention in office of the Trustee on the ground that it is not qualified, or not disinterested. Is there any such objection as that to the Trustee, or any objection of any kind to the retention of the Trustee?

* * * * * * *

[fol. 40] A. K. PARKER, JR., having been first duly sworn as a witness, testified as follows:

Direct examination.

By Mr. Fleming:

Q. State your name to the Court, please.

A. A. K. Parker, Jr.

Q. Where do you live?

A. I live at Welch, in McDowell County; that is my [fol. 41] legal residence.

Q. What is your official position?

A. I am a bond custodian of the State of West Virginia.

Q. And in what department are you situated?

A. West Virginia State Treasury Department.

Q. And you are a deputy under the State Treasurer of the State of West Virginia?

A. Yes, sir.

Q. And you have the official title of bond custodian; is that right?

A. Yes, sir.

Q. Particularly what securities, and for whom are you custodian?

A. Particularly for the Workmen's Compensation Fund, State Interest and Sinking Fund Commission, Department of Public Safety, West Virginia State Board of Control, and certain insurance companies, the Conservative Life Insurance Company of Wheeling, the George Washington Life Insurance Company of Charleston, the Investors' Syndicate of Minneapolis, Minnesota, and the Fidelity Assurance Association of Wheeling, West Virginia.

Q. Do you have securities, then, in your possession owned [fol. 42] by the Fidelity Assurance Association, the debtor in this case?

A. Yes, sir.

Q. How long have you occupied this position, Mr. Parker?

A. About five and a half years.

Q. How long have you had the securities of the Fidelity in your possession?

A. Five and a half years.

Mr. Palmer: If the Court please, I want to object to the witness' answers on the question of the securities being owned by the Fidelity Assurance Association, on the ground that that is a conclusion of law, unless more fully explained as to the witness' knowledge of the ownership.

The Court: Well, the Court knows that is a controverted question. Overruled. (Exception.)

Mr. Fleming:

Q. Was that when you came into this official position?

A. Yes, sir.

Q. And they have been in your custody ever since?

A. Yes, sir, in the joint custody of two custodians.

Q. Will you explain that to the Court, please?

Mr. Lauritzen: Mr. Fleming, do you mean the joint cus-
[fol. 43] tody part?

Mr. Fleming: Yes.

A. Well, by law two custodians are delegated to take care of the securities as a safeguard in the matter, more than anything else. Two custodians are delegated by law to take care of the securities on deposit with the State Treasury Department, and I am one of them, and Mr. W. R. Shaw is the other.

Q. Where are those securities kept?

A. You mean of the Fidelity?

Q. Yes.

A. They are kept in the state deposit vault of the Kanawha Valley Bank.

Q. And how long have they been there?

A. Ever since I have held this position.

Q. Five and a half years?

A. Yes, sir.

Q. Generally of what do the securities in your possession of Fidelity consist?

A. FHA mortgages, notes, certificates of interest in real estate properties, bonds, and I believe those are the major classifications.

Q. And particularly bonds, what class or character of
[fol. 44] bonds?

A. Real estate obligations, public utility bonds, railroad bonds and a small percentage of United States government bonds.

Q. During the five and a half years that these securities have been in the custody of yourself, has the character of them changed from time to time, or have they remained constant?

A. Well, my answer to that question is this: our duties are strictly custodial, and we do not inquire into the character of the assets or as to their value. That is determined by the Auditor of the State of West Virginia. We simply accept the securities and keep them in safekeeping.

Q. Now, what is the position of the Auditor of the State of West Virginia in reference to the Fidelity securities?

A. Well, perhaps he can explain it better, but I will put it this way: when securities are to be deposited, or withdrawn—that is, formerly; there have not been any exchanged for some months—the securities are turned over, that is, I mean the schedule covering the securities is turned over to the Securities Division of the Auditor's [fol. 45] office.

The Court:

Q. Turned over by whom?

A. By the representatives of Fidelity Assurance Association. The Securities Department examines the schedule to see the value of the assets named on the schedule. Then the schedule is approved in its entirety by the State Auditor. The procedure then is to go to the vaults of the Kanawha Valley Bank, where the securities usually, if they are to be deposited, have been shipped in. Then we check the securities against the schedule, which has been approved by the State Auditor, and simply deposit them to the accounts named on the schedule.

Mr. Palmer: May I make a suggestion and ask if it would be saving time in the hearing if we could stipulate that these securities are in the custody of this gentleman by virtue of certain West Virginia statutes, and agree upon those and perhaps save considerable proof, the statute referred to being Chapter 33, Article 9, Section 3, relating to the Auditor of the State, and Chapter 12, Article 5, as amended, of the Code of West Virginia?

The Court: I would prefer to have the facts brought out just as they are.

Mr. Fleming:

Q. Have you endeavored to evaluate these securities of [fol. 46] Fidelity in your custody?

A. No, sir, I have not attempted to evaluate them. The evaluation is made by the Securities Division of the Auditor's office.

Q. And who is the head of that division?

A. Mr. Edgar B. Sims really, but Mr. Robert Brown has active charge.

Q. Mr. Brown has charge of that?

A. Yes, sir.

Q. State whether or not Mr. Brown is charged with the duty, under the law, of evaluating those securities.

A. I can only say that I believe he is.

Q. Now, has the status or location of these securities changed within the past several months?

A. No, sir.

The Court:

Q. Within the past several months?

A. The principal amount on deposit changed within the last six months, but the status and location have not; they are the same.

Mr. Fleming:

Q. Will you explain that; if there has been a change will you just explain the change?

A. Well, in the past, although the account is, I think, as I say, frozen, and you will know what I mean by that; but in [fol. 47] the past securities were being constantly deposited and withdrawn from time to time. Naturally the net amount of the assets on deposit will vary according to those withdrawals and deposits.

Q. Would it vary materially?

A. Yes, sir, it has varied materially in the last six months.

Q. How much would you say?

A. May I refer to a paper I have?

Q. Yes.

The Court: Let us fix that as the first six months before June 7th.

Mr. Fleming: Yes, your Honor, I am going to.

A. That would be December 6th. Now, this figure gives the par or face amount of the securities on deposit on December 6, 1940, which was $17,710,375.50.

Q. On December 6, 1940?

A. That is correct.

Q. On June 6, 1941, what was the amount?

A. $16,338,283.68.

Q. And for each month between those dates?

A. On January 6, 1941, $17,629,075.50; February 6, 1941, $17,290,325.50; March 6, 1941, $12,990,425.50; April 6, 1941, [fol. 48] $15,715,883.68; May 6, 1941, $15,715,883.68.

Q. And June 6th?

A. I will repeat that: $16,338,283.68.

Q. Now, during this period, from December 6, 1940 to June 6, 1941, have there been interest payments or dividend payments upon these securities?

A. Well, I do not have the accurate information available, but our duties with the securities are periodically—usually once a month—to clip the coupons on all securities not in default. Those are turned over to the Fidelity Assurance Association and, of course, they are taken back to Wheeling with them and collected.

Q. And did you clip these coupons on these securities each month during this period?

A. No, sir.

Q. You did not?

A. I don't believe that the coupons have been clipped since about May 15, 1941.

Q. Was that when a local receivership occurred?

A. Just about that time; yes, sir.

Q. But prior to that time, what was done about that?

A. Prior to that time the coupons were clipped regularly once a month.

[fol. 49] Q. And what was done with them?

A. They were turned over usually to Mr. C. E. Smith, the representative of the Fidelity. That is, they were turned over to Mr. Smith, and Mr. Smith mailed them by registered mail back to Wheeling, and I believe they were collected through the local banks in Wheeling.

Q. And had that practice been followed through the entire time you had had these securities in your possession and custody?

A. Yes, sir; that is correct.

Q. I don't believe you stated where the securities were actually located, in what county, state and city; did you?

A. In the City of Charleston, Kanawha County, West Virginia, in the vaults of the Kanawha Valley Bank.

Mr. Fleming: You may cross-examine.

Cross-examination.

By Mr. Palmer:

Q. Mr. Parker, you are employed by the State Treasurer of West Virginia?

A. Yes, sir; that is correct.

Q. And as such employee, your only dealings with these bonds were as an employee of the State of West Virginia: [fol. 50] is that correct?

A. Yes, sir; that is true.

Q. And isn't it a fact that these bonds are deposited with the Treasurer of West Virginia by virtue of two provisions of the statutes of West Virginia, namely, Chapter 33, Article 9, Section 3, requiring a deposit to be made with the Auditor of the State; and Chapter 12, Article 5, as amended, requiring that that deposit be made with the State Treasurer; is not that correct?

A. I imagine that is correct; yes, sir.

Mr. Reinhardt:

Q. Well, do you know?

A. You mean do I know?

Q. Do you know whether that is correct?

A. I know that such deposit is required; but I do not know what section of the code it is, not from memory.

Mr. Palmer:

Q. As I understand, you know that what I have recited is correct, but you are not certain those particular sections are the exact sections of the code?

A. That is right.

Q. And you further know, do you not, that at the last session of the Legislature of West Virginia, had early in the year 1941, that Chapter 12, Article 5, requiring the deposit of certain funds, such as these bonds, with the State Treas- [fol. 51] urer was amended so that the Board of Public Works may now assess a premium or fee for that custody,

which goes into the general revenue of the State of West Virginia?

A. Yes, sir.

Q. Are you also familiar with the fact that in the statutes of West Virginia, Chapter 33, Article 9, Section 10, particularly these securities are deposited with the State of West Virginia, in trust for the benefit of contract holders?

A. Yes, sir, I understand that.

Q. And are you further familiar with the statutes of West Virginia to know that the State Auditor is Ex Officio Insurance Commissioner of the State?

A. Yes, sir.

Q. And that one person is Edgar B. Sims?

A. Yes, sir.

Q. And that the statutes provide in certain cases that the Auditor of the State, as Ex Officio Insurance Commissioner, can in the case of any insurance company take the assets of that insurance company and administer it for the benefit of its creditors?

A. Yes, sir.

Mr. Fleming: The debtor objects for the reason that [fol. 52] it presents purely a legal question and is not proper cross-examination.

The Court: I do not see where this adds to the Court's information, but I am going to let you go into that to a reasonable extent, if you wish. (Exception.)

Mr. Palmer: I think Mr. Fleming is probably right, your Honor, and under our laws of West Virginia, where the Court takes judicial knowledge of state statutes, I don't think we will be required to go any further into this.

Mr. Reinhardt: I was going to ask, your Honor, whether this Court does take judicial notice of those statutes, and I have in mind specifically not only the statutes of West Virginia, but also, if it become important in the course of this proceeding for the record to contain the statutes of other states in which deposits have been made, and I wondered what the situation on that is; whether or not they have to be physically introduced in evidence.

The Court: The attorneys had better satisfy themselves on that legal question.

Mr. Farmer: I think it is pretty plainly settled that the federal courts will take judicial notice of the statutes without proving them.

Mr. Palmer: I think we are all agreed on that, gentle-
[fol. 53] men, so that there will be no controversy about it.

Q. Mr. Parker, your custody of these bonds and your entire control and possession and dealing with them are controlled entirely by the state statutes of West Virginia, of which state you are an employee; is that correct?

A. Yes, sir.

Mr. Lauritzen:

Q. Mr. Parker, are you generally familiar with the individual securities held in this deposit, concerning which you have testified?

A. Well, I don't say that I could say accurately, but I believe I could recognize most of them if you named them, whether they were held or not.

Q. Can you tell us whether those securities are in bearer form, or whether they are in some other form.

A. They are for the greater part in bearer form; however, some of them are not, and our office is on record as notifying the State Auditor to that effect.

Q. And do they bear the endorsements of the officers of Fidelity in blank?

A. No, sir, not invariably.

The Court:

Q. You said you had notified the Auditor to the effect that some of them were not in bearer form. Explain that.
[fol. 54] A. Very often we will receive securities of the Fidelity Investment Association, of stock certificates that will be made out to the Fidelity Investment Association and will not be endorsed when placed on deposit with us. We have made notes to that effect on our various audits and consider it necessary to notify the Auditor that we consider it to be good practice to have those certificates endorsed. However, I consulted an Assistant Attorney General, and he said that probably such endorsement could be forced in event of liquidation.

Q. How much of the deposit is in that form, what percentage?

A. Your Honor, I don't believe I could say accurately: I would say possibly three to five per cent.

Mr. Lauritzen:

Q. Are endorsed or are not?

A. Are not endorsed. I don't know exactly; that is just a guess.

Q. Do you know what percentage of the securities consist of bearer bonds?

A. A very large percentage do.

Q. From your knowledge of securities, can you tell us whether, if these securities on deposit here should be lost, they are the type of securities that might be replaced [fol. 55] by Fidelity by putting up a bond of some kind with the concern issuing those securities?

A. I don't think that a bearer bond can usually be replaced, because that is a negotiable instrument and is just payable to bearer. It could be lost and, well, it is just lost, just like a thousand dollar bill.

Q. And what about those that are not bearer securities?

A. Well, that would be a little different proposition. They would not be of any value if they ever fell in any other hands, unless the endorsement could be forged or was properly assigned or endorsed.

Q. Mr. Parker, you mentioned certain transfers of securities that took place from time to time. Can you tell us generally whether the securities that you now have on deposit are, with respect to those identical securities, the same securities that you have had for a six months' period prior to June 6, 1941?

A. Those were first of all, I might say, not transfers. It was either a withdrawal or a deposit.

Q. By Fidelity?

A. For the main part, yes, sir. However, the major part of the securities have been held for a very long time. [fol. 56] Bonds will be called at times. At times a bond will be extended. It doesn't have to be sent back to have coupons taken care of and so forth; but for the main part they are the same securities that have been on deposit for the last six months.

Q. When you say "for the main part", can you be more specific, and tell us in what amount they are the same securities as have been there for six months?

A. Well, possibly it would be all right to mention one fact: there was a large amount of securities that were with-

drawn, as I have noted on a statement (referring to record) some time the latter part of February, and that was a material amount; that was about $4,000,000.

Q. Were withdrawn?

A. Yes, sir.

Q. And subsequently replaced by others, or not replaced?

A. The securities withdrawn were the Marston and Paull Companies, which I understand—I do not have any definite knowledge, but I understand—were set up by Fidelity to administer certain real estate bonds. The real estate bonds, as I understand it, were the underlying bonds behind the Marston and Paull corporation securities. Then [fol. 57] when the Marston and Paull Companies were dissolved, the underlying securities, by order of the State Auditor, were returned to the State of West Virginia, and are now on deposit with us.

Q. Mr. Parker, are you in position to tell us whether the major portion of all Fidelity's assets were ever located here in Charleston for a period of six months prior to June 6, 1941?

A. Well, of course, we are only interested in the part of the securities that the State of West Virginia holds; I mean as custodian. However, right now I could not tell you the figure on the total assets for the Fidelity, because it is really none of my business; but if you can tell me the total assets, I will tell you whether I think so, or not.

Q. You don't know the total assets, yourself?

A. No, sir, I do not.

Q. Can you tell us in dollar amounts within a six months' period prior to June 6, 1941, how many securities were continuously here on deposit in Charleston, owned by Fidelity, or originating from Fidelity?

The Court: Mr. Lauritzen, do you mean by that question, securities that were here that whole period of six months, and not withdrawn?

[fol. 58] Mr. Lauritzen: Not withdrawn or exchanged.

A. Well, I have given you the figures, the par amounts of securities held on the 6th of each month. Would not your question be answered by taking an average of those amounts shown?

Q. No.

The Court: What he means is, what particular securities in the aggregate were here all the time, as distinguished from those that were exchanged from time to time, or those that were withdrawn, replaced and so forth.

A. Well, of course, the major withdrawal was the $4,000,000 approximately, that I mentioned. In replacing those with some $2,900,000 they were put back, and if you leave those out, the major part of the remainder of the securities was here all the time. I think that was the only major exchange that was made. The other exchanges, as I said before, may have been temporary for the collection of interest or to be amended.

Q. That would have been about twelve and a half million, then?

A. Well, roughly that, yes, sir.

Mr. Lauritzen:

Q. When you speak of amount, do you mean face amount [fol. 59] of the securities or market value of those securities?

A. Face amount, or par value.

Q. Have you any means of telling us, within a six months' period prior to June 6, 1941, in dollars, the market value of securities that Fidelity had on deposit here?

A. No, sir; that is none of my business.

The Court:

Q. Whose business is it to keep that appraised?

A. Your Honor, that is the duty of the Securities Division of the Auditor's office, I understand.

Mr. Lauritzen:

Q. Are you familiar with the fact that the market value of these securities was considerably less than the face amount thereof during the six months' period prior to June 6, 1941?

A. I could not say so in the aggregate. Of course, some bonds that I am familiar with, I know that they are less, the par value, in some cases.

Q. You have no information on that subject?

A. No, sir.

Mr. Lauritzen: That is all I care to ask.
The Court: Is that all with this witness?

Mr. Reinhardt: Just one question, your Honor.

[fols. 60-64] Q. Are you an attorney?
A. No, sir.
The witness was then excused.

* * * * * * *

[fol. 65] Mr. Lauritzen: If the Court please, I have no desire to go further with seating arrangements, or anything of that sort, but I think there is one thing we are interested in knowing, and that is whether the Trustee herein, being an officer previously appointed by the Court, is assisting and aiding the petitioner in maintaining the allegations of his petition. If that is true, we would wish to challenge that as being wholly improper on the part of the Trustee, the Trustee having no interest whatever in taking part in a controversy presently arising between the petitioner and the answering creditors and intervenors.

Mr. T. C. Townsend: Do you want to provide special seats for somebody else; is that the idea?

Mr. Lauritzen: It is not the seating I object to, but I think we are entitled to a statement of your position in that regard, as to whether you are taking such a part.

The Court: The Court is going to permit all counsel to sit wherever they please, and to take such part as they deem advisable.

[fols. 66-69] Robert F. Brown, having been first duly sworn as a witness, testified as follows:

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Direct examination.

By Mr. Fleming:

Q. Give the Court your name, please.
A. Robert F. Brown.
Q. Where do you live, Mr. Brown?
A. 40 Poplar Avenue, Wheeling, West Virginia.
Q. Do you occupy some official position at this time?
A. Yes, sir.
Q. What position?

A. Deputy Securities Commissioner of the State of West Virginia.

Q. Under whom do you work?

A. Under Edgar B. Sims, who is State Auditor and Ex Officio Securities Commissioner.

[fol. 70] Q. Did you use Haskins & Sells' audit in making your evaluation?

A. No, not entirely.

Q. Who made a record in your office, if there was a record made?

A. I don't know what date you are speaking of.

Q. Well, around December 6, 1940.

A. That, I believe, was done by the State Auditor and the Deputy Insurance Commissioner and Mr. Smith of the insurance department.

Q. Well, are those gentlemen, or either of them, in town?

A. No, sir.

Q. Will they return soon?

A. I think so.

The Court: Let me ask a question:

Q. Mr. Brown, you said evaluations were made on the basis of the market value of the securities.

A. Well, whenever we made a check-up, we usually had three values: the par value, of course and the Auditor's valuation and the market value.

Q. Was the Auditor's valuation and the market value the same?

[fol. 71] A: No, sir.

Q. Which was higher?

A. The Auditor's valuation was higher.

Q. Why?

A. Well, the point was, as I understood it, that at no time did a corporation such as this—at no particular time did a corporation such as this have to deposit all of its securities on that particular date and, therefore, that the market value was a little severe.

Q. You mean if the security was quoted, say, at 50 on the market on a particular date, that you would value it, for the purposes of the Auditor, at 60, or some higher figure?

A. We had a regular formula, your Honor. Securities which were not in default were given a par value. Those which were in default were given the market value.

Q. Regardless of whether a security not in default had a market value of par, it was given the par value?

A. If it were not in default.

Q. Were there many securities that were listed on the market at a figure below the market value, those that were not in default, I mean?

A. There were some; I could not say with any degree of [fols. 72-76] certainty.

Q. Well, what about stocks; were there any stocks?

A. Yes, there were preferred stocks. They were always valued at the market.

Q. It is only with respect to bonds, then, that you mean to say that those that were not in default were always listed at par?

A. That is right; yes, your Honor.

* * * * * * *

[fols. 77-114] Mr. Lauritzen: If the Court please, I would like to record an objection to the Trustee taking part in this trial that is now taking place between the debtor, who is the petitioner, and these answering creditors.

The Court: Overruled. (Exception.)

[fol. 115] Frank J. McNulty, having been first duly sworn as a witness, testified as follows:

Direct examination.

By Mr. Fleming:

Q. You may state your name to the Court.

A. Frank J. McNulty.

Q. Where do you live, Mr. McNulty?

A. Wheeling, West Virginia.

Q. What is your occupation?

A. I have the title of Vice President of Fidelity.

Q. Are you actively employed in the work of that organization, Mr. McNulty?

A. Yes, sir.

Q. In what capacity?

A. I am now employed by the Trustee.

Q. What are you doing?

A. Well, I am more or less supervising the correspondence to contract holders and other incidental duties that are assigned by the Trustee.

Q. In other words, you read the correspondence that comes in from the contract holders from all over the country and reply to it; is that right?

A. Yes, sir; that is, I more or less supervise that work.

[fol. 116] Q. And you are familiar with that work?

A. Yes, sir.

Q. How long have you been doing that?

A. Well, I was assigned that job originally by the Receivers when they were appointed.

Q. That is, the State Court Receivers?

A. Yes, sir.

Q. And you have been doing it ever since?

A. Yes, sir.

Q. That covers what period, Mr. McNulty?

A. Well, since about April 11 to date.

Q. When did you first enter the employ of Fidelity?

A. In August, 1922.

Q. What did you do at that time?

A. I was more or less in a clerical position.

Q. In the office, you mean?

A. Yes, sir; in the office.

Q. At Wheeling, West Virginia?

A. At Wheeling, yes, sir.

Q. Was the new building built at that time?

A. No, sir.

Q. You were still in the old building?

A. Yes, sir.

Q. And where was that situated in Wheeling?

[fol. 117] A. 1229 Main Street, Wheeling.

Q. Do you remember the size of the company at that time, from an assets viewpoint?

A. Well, I don't remember definitely. I would say approximately around $2,000,000.

Q. And who was head of the company at that time, if you remember?

A. Mr. W. B. Irvine was President.

Q. Was he one of the founders of the company?

A. Well, he was one of the original incorporators, I believe.

Q. Do you know how long he had been with the company?

A. No, I could not say.

Q. Was he in active charge of the company at that time?

A. He was more or less serving in a part-time capacity.

Q. Who was in general charge of the business affairs?

A. Mr. Russell B. Irvine.

Q. Was that his son?

A. Yes, sir.

Q. What was the business of the company at that time?

A. It was the issuance of what we called the Special Income Contract.

Q. And is that the only type of contract that had been [fol. 118] issued up to that time?

A. Well, we had the—on our books what we called the old ten-year series, and the C and D series.

Q. Those were older series?

A. Yes.

Q. Do you know whether there are any of those series in existence now?

A. I don't—if there are any in existence, I don't know it. There are one or two minor amounts that have never been settled due to the inability to locate the original owners.

Q. But there are no active accounts in those series?

A. No, sir.

Q. And those are the series preceding the issuance of what is known as the Special Income Contract; is that right?

A. Yes, sir.

Q. Do you know how long the Special Income Contract had been sold or issued by the company prior to the time you came with it?

A. No, but I would say approximately it was started either in 1920 or 1921.

Q. And how long did the company continue to sell that contract, Mr. McNulty?

A. Well, up to 1925; might have included a part of 1925, I am not sure.

[fols. 119-120] Q. And are there still some contract holders in that classification who have that contract now?

A. Yes, sir.

Q. Do you know the number of them, or about the number?

A. Well, I think it is about 900-and-some-odd.

Q. About 900?

A. Yes. Now, that includes in different statuses; includes some of them that have not matured and some of them that may be considered as paid-up contracts.

* * * * * * *

[fol. 121] Q. Now, I believe you told us there were about 900 contract holders of the Special Income Contract?

A. Yes, sir.

Q. (The last question and answer on page 119 was then read by the reporter.)

Q. In other words, the liability existing as to each of those 900 contract holders under the Special Income Contract?

A. Yes, sir.

Q. Mr. McNulty, I hand you what has been marked Debtor's Exhibit No. 1, which you may examine and tell the Court what that is, if you will, please.

A. This is a Special Income Contract of Fidelity Investment Association.

Q. Is that the type of contract that was uniformly issued by the company to Special Income Contract holders?

A. Yes, sir.

Q. And this particular contract, what type contract is that in amount?

A. Well, this is a $2,000 face value.

Q. What other types in amount were issued, if you know, [fol. 122] from that classification of contract?

A. They were issued in two, four, six, ten, twelve and twenty thousand; issued in denominations of two, four, six, ten, twelve and twenty thousand dollars.

Q. How long did the company continue to issue that contract, if you know?

A. Well, it was to 1925.

Q. Through 1925?

A. I don't know whether it went through the full year 1925; approximately that.

Q. Did the company cease to issue that contract after that?

A. Yes, sir.

Q. Do you know how the company happened to quit issuing that contract?

A. Well, at that time there was some litigation with the State of Illinois in connection with the terms of the contract, and we were suspended from selling that particular contract during that litigation.

Q. In Illinois?

A. Yes, sir.

Q. In any other state?

A. Well, it was suspended in all states and then the [fol. 123] new contract was considered.

Q. Do you know why or the reason that litigation arose? Could you explain it to the Court?

A. Well, as I recall it was brought by the Secretary of State of Illinois.

Q. Do you remember why they objected to the Special Income Contract?

A. No, I don't recall the full details, but I think it was—it was my understanding it was on the grounds it was possibly misleading.

Q. But you don't know what provision?

A. No, I don't recall that exactly.

Q. Then was another contract formulated?

A. Yes, sir.

Q. Do you know who formulated that?

A. No, I don't.

Q. You did not have anything to do with it?

A. I did not have anything to do with it.

Q. Then when the company started selling contracts again you sold a different type contract?

A. Yes, sir.

Q. What was that type contract? What did you call it, if it had a name?

[fol. 124] A. The Special Annuity Contract.

Q. I now hand you what has been marked Debtor's Exhibit No. 2, which you may examine and state whether or not that is a specimen copy of the Special Annuity Contract concerning which you have just testified.

A. Yes, it is.

Q. And is this a specimen copy of all contracts which were sold in this class, except as to amount?

A. Yes, other than the paid-up contracts which were issued in lieu of that original contract.

Q. Will you explain those contracts, please?

A. Well, the paid-up contract was issued in lieu of the original contract, either at the request of the contract holder or in the event of one year's delinquency in making payments a paid-up contract was issued but contained certain values which were improved and retained the same maturity date as the original contract.

Q. Other than the amounts which you have mentioned were the provisions of the paid-up contract identical with

the provisions of the original contract, or were they different, Mr. McNulty?

A. Well, they were substantially the same provisions. It provided for cash values and——

[fol. 125] Q. But the general provisions of the contract were the same, were they?

A. Yes, except that the paid-up contract did not participate in the surplus.

Q. How long did the company continue to issue these Special Annuity Contracts, the form of which you have identified as Debtor's Exhibit No. 2?

A. Up to 1932; it might have included a portion of '32.

Q. Could you tell the Court approximately the amount of money collected by the company, by Fidelity, in the sale of Special Income Contracts?

A. I would have to refer to some records before I could do that.

Q. Do you have those records here?

A. No, I don't have them here.

Q. You don't know how much was paid out under those contracts either, I don't suppose, do you?

A. No.

Q. You say in 1922 is when you went with the company?

A. Yes, sir.

Q. At that time the company had assets amounting to about $2,000,000?

A. That is approximately my recollection.

[fol. 126] Q. And in what form were those assets at that time?

A. Well, as I recall it they were in the form of bonds, securities, cash and the home office building.

Q. Were any of those deposited with any of the state agencies under depository acts at that time?

Mr. Palmer: Objection to the term "state agencies."

Mr. Fleming: I think that term is very general and a very well understood term.

The Court: Overruled. (Exception.)

A. Well, I don't recall; I could not say because I don't know.

Mr. Fleming:

Q. When the company abandoned the sale of Special Income Contracts that was about 1925?

A. The Special Income Contracts, yes.

Q. Do you remember what the assets were, or about what they amounted to at that time?

A. No, I don't recall.

Q. Had they increased, if you remember?

A. Oh, yes, I would say they had increased substantially at that time.

Q. Do you know whether any of the securities were deposited with any state agency at that time?

A. Well, I can't say for certain but I believe they [fol. 127] were.

Q. Do you remember in what states?

A. I would say they would be deposited in West Virginia.

Q. When did Fidelity begin the sale of the Special Annuity Contract?

A. I think the first sales were approximately 1925.

Q. That is, the sale of contracts was not suspended very long?

A. No, it was just a temporary time, a short time.

Q. Do you remember how long?

A. Oh, several months.

Q. Then how long did the sale of Special Annuity Contracts continue?

A. Up to and possibly including part of the year 1932.

Q. Do you remember what the assets of Fidelity were at the time you ceased selling Special Annuity Contracts?

A. I can't say but I believe they were in excess of $25,000,000.

Q. The company had grown then?

A. Yes, sir.

Q. And that was in 1932?

A. 1932.

Q. 1932?

[fol. 128] A. Yes.

Q. What were the assets of the company, or approximately the assets, say in 1929, if you remember?

A. I would say approximately around $20,000,000 but I can't say for certain.

Q. Do you recall how the depression—you remember the depression of course, the beginning of it, don't you?

A. Yes, sir.

Q. In the years 1930, 1931 and 1932, do you remember how the depression affected the value of the assets of Fidelity, Mr. McNulty?

A. Well, it did naturally have an adverse effect.

Q. Now at that time what were the assets of Fidelity invested in, if you know?

A. In bonds; possibly there might have been some small investment in stocks at that time.

Q. Any real estate?

A. There were some real estate bonds, I would say, I am not certain as to the actual real estate but I don't believe at that time there was, outside of the home office building.

Q. And you think during that period the assets of Fidelity were of the value of approximately $20,000,000; is that [fol. 129] right?

A. Yes.

The Court: I think he said $25,000,000 in 1932.

The Witness: Yes, $25,000,000 in 1932, but I can't say that with any certainty.

Mr. Fleming:

Q. What capacity did you have with the company during that period, say from 1930 to 1932?

A. Assistant Secretary.

Q. And you had other duties other than that, did you?

A. Yes.

Q. What did you actually do?

A. Well, the preparation and filing of various reports to the state departments, some tax returns and more or less of the character of general activities in that connection.

Q. Do you remember who was head of Fidelity about that time, Mr. McNulty?

A. In 1932?

Q. Yes.

A. Late in 1932 Mr. John W. Paull became President.

Q. Who was he?

A. Well, I understand he was formerly Comptroller of the Currency of the United States.

[fol. 130] Q. Did he succeed Russell Irvine?

A. No, Mr. D. A. Burt succeeded Mr. Irvine.

Q. D. A. Burt succeeded Mr. Irvine?

A. Yes.

Q. How did he happen to succeed Mr. Irvine, if you know, Mr. McNulty?

A. I don't know, except by action of the board of directors.

Q. You don't know of any reason for it?

A. No, sir.

Q. Do you know why Mr. Paull succeeded Mr. Burt?

A. No.

Q. What about the business affairs of Fidelity? Had they made progress or had they gone backward?

A. I would say they had made progress.

Q. And how were the sales of Fidelity handled?

A. They were handled through a corporation known as the National Sales Agency, Inc.

Q. Do you remember when that sales agency was incorporated, or about when?

A. I think approximately about 1913, somewhere along there, as I recall.

Q. That was a separate organization?

[fol. 131] A. Yes, sir.

Q. And that organization was paid a commission upon its contracts?

A. Yes, sir.

Q. That were sold?

A. Yes, sir.

Q. Do you recall the time when the sales policy permitted the payment of advance commissions probably to that organization?

A. Yes, sir.

Q. About when did that policy arise?

A. Approximately 1928 or 1929.

Q. And who was head of the sales agency at that time?

A. Fred M. King.

Q. Who was head of Fidelity at that time?

A. I think at that time Mr. D. A. Burt.

Q. How long did that sales agency continue to sell contracts for Fidelity, if you know?

A. I think up until—or part of the year 1935.

Q. And how long a period then did this sales agency sell contracts for Fidelity?

A. Well, from the time that they were incorporated up until approximately 1934 or 1935.

[fol. 132] Q. How many years would that be?

A. Oh, about 22 years.

Q. Did this policy of paying the sales agency advance commissions continue until around 1934 or 1935?

A. Yes, I would say it did.

Q. Until they quit selling contracts for Fidelity?

A. Yes, sir.

Q. Now, during this entire period in which they represented Fidelity were they the exclusive sales agency for Fidelity contracts throughout the country?

A. Well, not for that entire period, but up until about 1925, I think it was, and a corporation by the name of Irving & Sisson of Chicago, Illinois, had the contract for the sale of contracts for the West, the Chicago District, and the National Sales Agency had the eastern part of the United States.

Q. Then those two companies had the exclusive selling contracts with Fidelity?

A. Yes, sir.

Q. Now did there come a time when Fidelity quit selling the Special Annuity Contract?

A. Yes, sir.

Q. When was that?

[fol. 133] A. In 1932, the early part of 1932.

Q. And how did that happen?

A. I don't know just the exact reasons, but I think it was due to the change in economic conditions and they felt a new type of contract should be developed.

Q. Did the interest rate on these contracts have anything to do with the change at that time?

A. Well, I don't know but I think that that was considered in there.

Q. Do you remember what the interest rate was in the Special Income Contract?

A. It was a 5% contract.

Q. And the Special Annuity Contract?

A. That was 4½%, until the last payment was made and then it was 5% from that time on.

Q. And the next type of contract, what was that?

A. The Series A was a 4% contract compounded quarterly.

Q. When did Fidelity commence selling that contract?

A. 1932.

Q. And how long was that form of contract sold, about how long?

A. Approximately to 1934; maybe including part of the year 1934.

[fols.134-138] Q. I hand you here what has been marked Debtor's Exhibit No. 3, which you may examine and state

whether or not that is the Series A contract to which you have just referred.

A. Yes, sir.

Q. Will you explain why you referred to this as the Series A contract, particularly as the contract bears the title Income Reserve Contract.

A. Well, I can explain why that was definitely called an Income Reserve Series A.

Q. All right, was it for the purpose of classification or separation from the later B, C and D contracts?

A. That was surely the intention of it, in the event of any subsequent issues.

[fol. 139] Q. Then how did you happen to quit selling Series A Income Reserve contracts? That is, if you know.

A. Well, I can't answer that definitely except that it was felt that probably a new contract containing some advantages or benefits that were not included in the former series was needed.

Q. And what was the next series of contract that was issued?

A. That was the Income Reserve Series B.

Q. Now, when did you commence the sale of that series?

A. 1934.

Q. Did you have some difficulty with your sales organization about that time, or did you reshape your sales organization, or what was done, if anything?

A. Yes, at that time I would say that the contract with the National Sales Agency, Inc., was cancelled.

Q. And if there was a large loss or deficiency occurring at that time in connection with that sales organization explain that to the Court, if you will.

A. Well, at that time the agency division was started for the purpose of operating for the National Sales Agency with the intention of all profits accruing through the opera-
[fol. 140] tions of the agency division would be applied on the indebtedness owed to the association by the National Sales Agency, Inc.

Q. Did the National Sales Agency owe the company a large amount at that time?

A. Yes, they did.

Q. Do you remember about the amount?

A. As I recall, at that time it was somewhat over a million dollars.

Q. And did it have any assets, the Sales Agency, at that time?

A. Well, it had some equipment in some of the branch offices.

Q. Of much value?

A. Oh, not of large value. I would say probably twenty-five or thirty thousand dollars.

Q. Was the business or policy of the company in reference to the sale of contracts, all types of contracts, changed about that time?

A. As to the method of sales?

Q. No, as to any additions that were made to the contracts by way of benefits or by way of insurance.

A. Well, by the inclusion of the insurance provision of [fol. 141] the Income Reserve Series B Contract.

Q. That had an insurance provision, did it?

A. Yes, sir.

Q. For all policyholders?

A. No.

Q. Just explain that if you will.

A. That insurance was obtained by the association from a regular reserve life insurance company and it provided that in the event of death of the contract holder after one payment was made that the insurance company would pay to the association an amount sufficient for the association to declare the contract fully paid.

Q. In other words, the insurance company, which was entirely independent from Fidelity, would insure the performance of the contract to Fidelity?

A. Yes, the insurance coverage was handled entirely by the insurance company. Of course, they would require the submission of proof and an application for the insurance.

Q. Was that insurance brought about upon the group principle of insurance without physical examination, or by physical examination?

A. Well, the insurance company could demand physical examination after the age of 50, I think it was, or when [fol. 142] some facts in the insurance application showed that an examination was advisable.

Q. And who paid for that insurance provision?

A. Well, the association paid the insurance company direct the premium.

Mr. Palmer: Another interruption, if you will permit me: I notice you said the insurance policy, in the event of death, provided for a paid-up policy. I think there should be a distinction drawn that that was not, however, the full amount of the face value of the policy, but was a value up to a certain date and then you had to let it rest for ten and a half years in order to get the full amount of the face value. I think the witness can bring that out clearer than I can, however.

Mr. Fleming:

Q. Will you explain the method under which Series B Income Reserve contracts containing the insurance provision were handled?

A. Well, the applicant would submit the application to the insurance company and if acceptable to them they would advise the association that that insurance was acceptable, and that insurance provided that in the event of death of the registered contract holder all remaining unpaid payments at that time would be paid for on a discounted basis [fol. 143] by the insurance company and the original maturity date remained unchanged, of the contract. The estate had the option then at that time of taking the cash surrender value showed by the schedule or leaving the contract there until the original maturity date, at which time they could exercise the same options as the original holder had he lived.

Mr. Palmer: It has been suggested perhaps in further explanation of this copies of the insurance contract should be introduced in evidence so that the exact terms of that could be had, not in contradiction of the witness but in further explanation of this.

The Court: I assume that is Mr. Fleming's intention.

Mr. Fleming: Do we have any of those policies?

Mr. Hillis Townsend: Your Honor, that is in the record as an exhibit in a petition filed by the Trustee.

The Court: Then there is no use putting it in again.

Mr. Fleming: It is not in this record, is it?

Mr. Hillis Townsend: Not in this one today, no.

The Court: You can just refer to it.

Mr. Hillis Townsend: It is in the record as an exhibit to one of the petitions filed by the Trustee.

Mr. Palmer: Can it be identified as being the same insurance policy of which this witness is speaking, so that this [fol. 144] record will show that it is the same one?

Mr. Fleming: If we could have the Clerk get that petition with the exhibit attached to it I would like to have it identified as being the same policy.

The Court: All right, you may do that later. Proceed with the examination.

Mr. Fleming:

Q. I now hand you what the reporter has marked for identification Exhibit No. 4, which you may examine and state whether or not that is a specimen copy of the Series B Income Reserve Contract to which you have just referred.

A. It is.

Q. And is that identical in form with all contracts issued in that series?

A. With the exception of the amounts, the denominations, and the income reserve provided for the issuance of a paid-up contract.

Q. How long were these contracts, Series B Income Reserve contracts, sold?

A. They were sold up until—through December, 1940.

Q. And that was when the company ceased to sell contracts at all?

A. Yes, sir.

Q. Did you issue any other forms of contract after Series [fols. 145-147] B was developed and sold?

A. Yes, we issued an Income Reserve Series D Contract.

Q. How did you happen to issue that contract?

A. Well, the Income Reserve Series D did not have the insurance provision, and some states felt that we could not offer a contract containing insurance without possibly being considered as an insurance company.

Q. That is, in other words, Ohio, Kentucky and some other state——

A. Alabama, yes.

Q. —and Alabama refused to permit you to sell annuity contracts as you had been doing containing the insurance provision?

A. Yes, sir.

Q. When did you first commence selling Series D Income Reserve contracts?

A. That was in 1935.

Q. How long was the sale of those contracts continued?

A. Well, up until December 1940, with the exception of one state; in Ohio it was discontinued prior to that date.

. . . . . .

[fol. 148] Q. Was any other type or character of business operated or accomplished by Fidelity during this entire [fol. 149] period that you were with the company up to the present time?

A. No, sir.

Q. And were there any other types of contracts issued and sold by Fidelity other than these contracts which you have identified as being Exhibits 1, 2, 3, 4, and 5?

A. There was a contract termed the Income Reserve Series C Contract.

Q. Tell us about that.

A. That was issued only in the State of Wisconsin and it was issued in connection with the unemployment set-up that Wisconsin had, and that had been—they adopted this type of contract, or had approved it, as a means of companies investing in that fund for the unemployment fund.

Q. Were any of those contracts sold?

A. Yes.

Q. How many?

A. Oh, there were several hundred of them sold and they were discontinued then when—my understanding is when the federal government adopted the social security that Wisconsin had no further use for their fund, as I understand it.

Q. And are there any of those contracts outstanding now, Mr. McNulty?

A. Yes, I would say there are approximately twenty of them.

[fol. 150] Q. They are all in Wisconsin?

A. Yes, but they are not active contracts now.

Q. Now, as this money would come in from the sale of these contracts what did Fidelity do with the money, if you know?

A. Well, it would be—when the payments came in the contract holders in those cases returned with the money a particular stub which indicated the series and the number of the particular contract, as well as the name and address. They would be sorted then by contract series and the appli-

cation of credit made to the individual account cards and the money, of course, deposited in the bank.

Q. And later were securities purchased?

A. Yes.

Q. And when you first came in did you know who had charge of the purchase of securities at that time, that is, back in 1922?

A. As I recall it, the Investment Committee.

Q. You probably don't remember who they were at that time, do you?

A. No, I could not say.

Q. And was that policy continued down through the years?

A. Yes, the Investment Committee passed on all securi-
[fol. 151] ties, or all investments and the sales of any securities.

Q. Now, in recent years who has handled the purchase of securities?

A. Well, the Investment Committee of course governed the purchase of any security or the sale of any security.

Q. But have you had a special employee or representative who has devoted considerable time to that?

A. Yes, Mr. Hubert F. Young.

Q. Where does he live?

A. In New York State.

Q. Is he a broker?

A. No, he was an employee of the company.

Q. An employee of the company?

A. Yes.

Q. And he devotes all of his time to the company?

A. Yes, sir.

Q. He, as I understand them, recommends the purchase of securities and the sale of securities?

A. That is right.

Q. And then that is either approved or disapproved by the Investment Committee; is that the way the investments of the company have been handled in recent years?

A. Yes, sir.

[fol. 152] Q. Do you know how they were handled prior to the time Mr. Young came into the employ of the company?

A. No, except through the Investment Committee which would have meetings on the type of securities to be purchased, and would authorize an officer to proceed with the purchase or sale of any security.

Q. Did the company at various times own real estate other than their office building?

A. Yes.

Q. I mean, for purposes of investment and profit?

A. Well, as I recall it the real estate that the association did have, other than its home office buildings, was taken over by the foreclosure of mortgage bonds.

Q. And how was that managed?

A. Well, that would be a matter for the Investment Committee.

Q. Well, would it be rented?

A. Oh, yes.

Q. And rental would be collected?

A. Yes, sir.

Q. And was that handled through the general offices in Wheeling or by some private rental agency?

A. I think in some cases it was handled by rental agen-
[fol. 153] cies and others direct by the company itself.

Q. Now, when the securities were purchased by this Investment Committee for the company would those securities from time to time be deposited with various state agencies?

A. Yes, sir.

Q. Do you remember when that situation first arose?

A. Well, as I recall it a deposit was always maintained in the State of West Virginia.

Q. Under the special act under which the company, I understand, was incorporated?

A. Yes, sir; and then in Pennsylvania, in order to qualify there, there was a statutory requirement for a deposit of $100,000, which likewise was made; but as to the dates or time that these various states——

Q. (Interposing): Well, what about other states which from time to time required deposits? Do you remember about that—deposits of securities, I mean?

A. You mean as to the approximate dates?

Q. Yes, just generally. What states were they, first?

A. Well, there was the State of Georgia that had a statutory requirement.

Q. Do you remember about Wisconsin?

A. Yes.

[fol.154] Q. Do you remember when you first commenced to deposit securities in the State of Wisconsin?

A. Approximately around 1930 or 1931.

Q. And what about Illinois?

A. I think about approximately the same date.

Q. Now, as these securities were deposited in the various states under their depository law requirements, were the securities segregated into classes in accordance with whether the securities were purchased by moneys paid in, say on each of these series of contracts which Fidelity had sold, or was selling?

A. Each reserve fund had its own investment which was composed of money received by that particular contract fund.

Q. In other words, the moneys that came in from the sale of each of these classes of contracts which you have identified as Exhibits 1, 2, 3, 4, and 5, were set aside for the security or benefit of those contract holders?

A. Yes, our records were earmarked as to that.

Mr. T. C. Townsend:

Q. What did you say?

A. The securities were so recorded so that each contract fund had its own security.

Mr. Fleming:

Q. And were specific securities purchased from moneys derived from the sales of contracts of each of these classes [fol. 155-162] that went into the securities and then the securities you kept a record of each specific security class; is that right?

A. Yes, sir.

Q. Now, when those securities were deposited in the various states were the securities intermingled or were they kept separate in accordance with the number and amount of contracts existing in those states?

A. Well, as far as our records were concerned they were not intermingled or commingled, but in making deposits with the various states on some occasions the securities belonging to one particular fund would be sent out as a deposit not specifically for that particular fund but to build up the deposit as a whole, to cover the liability in that state.

* * * * * * *

[fol. 163] Q. About how many letters have you received or have been received by the Fidelity from Contract holders, would you say, during that period of time?

Mr. Palmer: That is, from April 11 to the present time?

Mr. Fleming: Yes, to the present time.

A. Well, that would be had to determine because in a great many instances we have had subsequent letters to the first one, and maybe some information was sent out and they [fol. 164] write back again. In some cases the same contract holder has written more than once.

Q. Say from different contract holders.

A. I would say approximately 7500 or 10,000.

Q. Could you tell just generally what states those letters have come from?

A. I could not say that definitely.

Q. Have you read all of those letters yourself?

A. I have not read all letters personally.

Q. In those letters have expressions been made by contract holders in reference to the future of Fidelity?

A. Yes, they have in a great many letters.

Q. And what has been that expression or what have been those expressions?

A. Well, it has been different—there have been quite a variety of expressions.

Q. I mean by that, have they expressed anxiety over the fact that Fidelity might be liq dated?

A. Well, that is possibly one of the main topics of the letters, is their concern over their contracts and what is going to happen to them.

Q. And what has been the sentiment in reference to rehabilitation of Fidelity through reorganization?

[fol. 165] Mr. Lauritzen: If the Court please, I object to that question and the question previously asked, unless it is shown from whom these letters were received and whether in response to a question as to what should be done with the company, and unless we have an opportunity to examine those letters which are, after all, the best evidence of the facts therein contained and which are readily available to the debtor to be produced in this proceeding.

The Court: Well, could you do that? You would not want to examine 10,000 letters, would you? The Court would not permit the delay of this hearing to do that. I think this evidence is proper except that the question seemed to the Court that it was too general as to what was the sentiment. I think this witness ought to give his answer in some proportionate form or some percentage basis, approximately;

that is, as to what proportion of these who expressed themselves wanted reorganization.

Mr. Palmer: Might I make a further suggestion to keep it from being objectionable? To ask the witness what sentiment was expressed really calls for an expression of the witness' opinion as to what was said. Would it not be better to say or to ask what did the letters express from the writers as to whether they desired reorganization or liquidation, [fol. 166] and so forth?

Mr. Fleming: I think that would be proper.

The Court: If you can get it in terms of proportions.

Mr. Farmer: And also what they wrote these creditors, if the Court please. If they led them to think they were going to get their money right away, that is a different thing from having to wait a long time.

The Court: You may cross-examine on that.

Mr. Fleming: Were there expressions contained in these letters or divers of them in reference to the rehabilitation or reorganization of Fidelity?

A. Yes, although not a great many. The subject or the word reorganization was not used. A great many cases the people said they would withhold making further payments on their contracts until something definite was worked out on it, and other cases they requested paid-up contracts until something definite was worked out.

Q. Were there expressions of willingness to continue to pay on the contracts in a number of letters?

A. Yes.

Q. And what has been your experience during the past three months, three or four months, since April 11, 1941, in reference to the continuation of various contract holders to [fol. 167] pay under their contracts?

Mr. Palmer: May we ask that that be divided into two periods? The period under the state court receivership and the period under this Court's trusteeship, for the reason there may be or may not be—I don't know—a change in the writers during that period which might make some reflection as to the express wishes of those persons, if the witness is able to do it.

The Court: The witness can bear that in mind in answering the question.

The Witness: I am asked to designate between the two different periods? It would be hard to do and I could not answer that definitely because I have not made any recap. of that condition.

The Court:

Q. Have you noticed any difference since the petition for reorganization was filed? Have you noticed any falling off of receipts from persons who are continuing to pay?

A. Well, there has been a gradual decrease in the continuation of payments.

Q. Well, has it been a gradual decrease since the receivers were appointed, or was there any noticeable difference in the rate of decrease after the petition for reorganization [fol. 168] was filed?

A. Well, as to the payments actually made I can't answer that question because I am not familiar with the exact figures as shown by the books on that particular question.

Mr. Palmer:

Q. Who would be able to answer that question as to the amounts paid in by the contract holders between April 11 and June 6, and June 6 and the present time?

A. That could be determined by our auditor from the records.

Mr. Fleming: I think we have the auditor here and he will probably be able to answer that.

Q. Mr. McNulty, do you think you have sufficient knowledge of the affairs of this company to give any opinion upon the question of reorganization or rehabilitation of the affairs of the company?

A. Yes, sir; I feel that I do.

Q. Would you give that to the Court, please?

A. Well, I feel that a reorganization is the only way to work to the best advantage and benefit of the contract holders. I certainly don't think that a liquidation would do anything other than result in losses to the contract holders.

The Court:

Q. Now, Mr. McNulty, give the Court your basis of feeling [fols. 169-175] that, if you do feel so, a reorganization is feasible in this case.

A. Well, the only basis that—the one basis that I make that assumption on is from the general tone of the correspondence that I have seen with the contract holders. By that I mean there have been very few letters that I have seen that have been caustic or critical.

Q. Do I understand from what you say now you feel that the determination of whether a reorganization is possible or feasible or not depends on the attitude of the holders of the contracts, and that if their attitude is favorable to a reorganization then a reorganization can be effected; is that your idea?

A. Yes, sir.

Q. Then if their attitude was against reorganization, in large numbers, that would mean that it was not very likely reorganization could be had?

A. That is the way I feel.

[fol. 176] Q. Isn't it true that you were asked in that meeting by those men there present to become a member of the board of directors for the purpose of forming a quorum?

A. I was.

Q. And isn't it a fact that you refused to do so?

A. Yes, sir.

Q. And isn't it a fact that there was discussion concerning you and whether or not you should join in with the then purposes of the meeting, and that you then said, "If I am not wanted I will resign as Secretary of the corporation," or words to that effect?

A. Well, there was a discussion, general discussion, and I offered to resign as Secretary, and I did submit my resignation.

Q. And those present gladly accepted your resignation?

A. Well, they accepted it; I could not say how gladly.

Q. I will withdraw the word "gladly." Now, at the meeting when it was found there was not a quorum present, isn't it a fact that Mr. Fleming suggested that you be elected a director?

A. I think that the suggestion was made by Mr. Fleming.

Q. This same Mr. Fleming who is now appearing here as counsel for the debtor?

[fol. 177] A. Yes, sir.

Q. Isn't it further a fact Mr. John Marshall stated it would be agreeable to him but he felt there should be an attorney elected to the board?

A. Yes, sir.

Q. At the end of that meeting of the board of directors, isn't it true that after you refused to serve as a member of the board of directors Mr. Fleming said that while he did not desire to become a member of the board, in the light of future matters, since an emergency confronted them he would consent to serve on the board during the period of that meeting and would resign at the end of that meeting, and did resign at the end of that meeting of the board of directors?

A. Well, as I recall it, that is generally my recollection of what happened.

Q. In substance what I have asked you is correct, is that right?

A. Yes, according to my recollection.

Q. Now, in fairness to Mr. Fleming, it is true, is it not, that this meeting was called by the other members of the board of directors there present and not by Mr. Fleming?

A. Well, I can't answer that question. I don't know who [fol. 178] called the meeting.

Q. Was Mr. Fleming thereupon elected to the board of directors?

A. Yes, sir.

Mr. Reinhardt: May I ask the witness whether he was present at the meeting at the time Mr. Fleming was elected?

Mr. Palmer:

Q. Were you present at the meeting at the time Mr. Fleming was elected?

A. Yes, I was.

Q. Now, do you know whether at the end of that meeting Mr. Fleming did resign immediately from the board of directors?

A. No, I can't answer that; I don't know.

Q. Do you know whether the purported minutes of that meeting as taken by the secretary who acted after you resigned show that Mr. Fleming did resign at the end of that meeting?

A. I do not know. I cannot answer that.

Mr. Palmer: May we have those minutes to see whether they so state?

Mr. Fleming: Yes. I did resign.

Mr. Palmer: And that is reflected in those minutes?

Mr. Fleming: Yes.

[fol. 179] Mr. Palmer: You resigned at the end of that meeting?

Mr. Fleming: Yes.

Mr. Palmer:

Q. The election of Mr. Fleming was by the board of directors to fill a vacancy existing in the board of directors; is that correct?

A. Yes, sir.

Q. May I ask you whether or not at the time of that election and serving of Mr. Fleming he was a stockholder of Fidelity Assurance Association?

A. Not according to the records, no, he was not a stockholder.

Mr. Palmer: Mr. Fleming, may we agree at that time you were not a stockholder of record of the company?

Mr. Fleming: Oh, I don't know. If I was a stockholder it was purely for the purpose of serving as a director.

Mr. Palmer: You were not a stockholder of record as of that time?

Mr. Fleming: No.

Mr. Palmer: And any stock you may have held was given you at that time for the purpose of qualifying as a director of that meeting?

Mr. Fleming: Yes, that is right.

Mr. Palmer: Did they actually give you any, or was just [fol. 180] a promise made that you would have certain stock during the time you were elected and then at the end of that meeting that was forgotten?

Mr. Fleming: No, I was not delivered any certificate.

* * * * * * *

[fol. 181] Q. Were there any other persons present than those you have named: yourself, Mr. Fleming and the six directors?

[fols. 182-186] A. No, sir.

Q. How many other directors were there of Fidelity at that time who were actually qualified and serving?

A. There were just two.

Q. Who were they?

A. F. S. Risley and D A. Burt.

Q. Did either of them come to or attend that meeting?

A. No, sir.

Q. Did they agree, to your knowledge, to the holding of the meeting in Pittsburgh?

A. No, sir—I don't just understand.

Q. Do you know whether or not Mr. Risley and Mr. D. A. Burt agreed that it was all right with them to hold the meeting of the board of directors in Pittsburgh?

A. No, I don't know.

Q. Both Mr. Risley and Mr. Burt, as well as Mr. King, were then residents of the City of Wheeling, the home office of the Fidelity company, as well as yourself; is that right?

A. Mr. Risley was not living in Wheeling at that time.

Q. He was not?

A. No.

Q. Mr. D. A. Burt was?

A. Yes, sir.

. . . . . .

[fol. 187] Q. And it is further true, is it not, that up until that meeting of June 3 Mr. Fleming had no connection with the company?

A. No, sir; not to my knowledge.

Q. And you were Secretary of Fidelity?

A. Yes, sir.

Q. Now, is it not further true that, as was asked here earlier today, some two years ago approximately there was a plan advocated whereby one Mr. Messick and associates would buy certain stock or invest certain money in the [fol. 188] capital structure of Fidelity?

A. Well, that provided for the creation of a new company. There was no provision for money to be put directly into Fidelity.

Q. Well, my question is only leading up to a further question, in that in pursuance of this plan whereby there was to be, if possible, worked out between Mr. Messick and the stockholders of Fidelity certain agreements, Mr. John Marshall became the voting trustee of a large majority of all the stock; is that correct?

A. Yes, sir.

Q. And that plan called for Mr. Marshall to be more or less a one man committee having all the rights of the majority stockholders?

Mr. T. C. Townsend: Objection.

Mr. Palmer: This is only the background leading to the further part.

Mr. T. C. Townsend: I don't see much use in putting the answers in his mouth.

Mr. Palmer: It is cross-examination.

The Court: The objection is overruled. (Exception.)

A. Under that trust agreement he had the right to vote that stock.

[fol. 189] Mr. Palmer: I don't want to go too deeply into this, if the Court please, but I want it as background for further questions, and that is the only purpose of it.

The Court: All right, proceed.

Mr. Palmer:

Q. That plan called, in substance, for Mr. Messick and associates to invest either in a new company, as you have stated, or to advance to the Fidelity in some form approximately half a million dollars; is that right?

A. Yes.

Q. And that plan fell through?

A. Yes, sir.

Q. And Mr. Messick's connection with the company started at that time; is that right?

A. Yes, sir; approximately at the same time.

Q. And he then after that plan fell through became chairman of the board of Fidelity, did he not?

A. Yes.

Q. And did not invest a nickel in the company; isn't that right?

A. Not to my knowledge.

Q. He is and was the owner of only one share of stock; isn't that right?

A. I think that is what the record shows.

[fol. 190] Q. And can you tell us whether or not Mr. Fleming's entire connection with the company has been through his relationship with Mr. Messick?

A. Well, I am not familiar with that. I can't answer that question.

Q. And is it not true further that Mr. Messick, after he became chairman of the board of Fidelity, drew a salary of $1,000 a month?

A. For a period he did, yes, sir.

Q. And that period of time extended until Mr. Sims, the Auditor of West Virginia, demanded that that salary cease?

A. Yes.

Q. Now, during that period of time that Mr. Messick drew that money how many days a week did he spend in the City of Wheeling on the business of Fidelity, if you know?

Mr. Fleming: The debtor objects to this. It is not relevant nor cross-examination.

The Court: Overruled. (Exception.)

Mr. Palmer: Answer the question.

A. Well, he was down occasionally for a day or two.

Q. That would be one day or two out of a week, or out of a month?

A. Well, no set period. I can't be definite on that.

[fol. 191] Q. Did he spend more than three days per month on the business of Fidelity in the City of Wheeling at its home office where you were located and were secretary of the company?

A. I can't answer that definitely.

Q. To the best of your knowledge?

A. Why, I would say that he spent probably three days.

Q. Per month?

A. Yes, sir; might have been more than that. I can't answer that definitely.

Q. Now, can you tell me whether or not in the summer of 1938, when the Securities and Exchange Commission filed a civil action against the debtor in the United States District Court for the Eastern District of Michigan, Southern Division, the six directors, with the exception of Mr. Messick, were not also directors of the debtor or officers of the debtor at that time?

A. With the exception of Mr. Pulfer—he was connected with the company but I don't recall exactly whether he was an officer or director at that time.

Q. He was an employee of the company at that time, was he not?

A. Yes.

Q. Do you know whether you and the other officers and [fols. 192-195] directors during this year filed with the Securities and Exchange Commission an application for exemption from ineligibility imposed by Section 9a of the Investment Company Act of 1940 whereby, by reason of the decree entered in the federal court in Michigan the officers and directors, including those six, with the exception of Mr. Messick, were ineligible to serve Fidelity by virtue of the Investment Company Act?

A. Well, I filed the application for exemption.

Q. Did the others?

A. I think they all did, yes, sir.

Q. And isn't it true that a temporary exemption was granted, which was very shortly after that revoked?

A. I don't know whether exemption was granted or not. I know that I did see a release wherein it said temporary exemption was granted, and in a day or two release was made that that was in error.

Q. Release was what?

A. That the former release was in error, and that the temporary exemption had not been granted.

Q. And therefore at the time of this meeting there had been no exemption granted to these officers and directors, including yourself, by the Securities and Exchange Commission to act as such, had there?

A. Not to my knowledge.

. . . . . .

[fol. 196] Q. Now, Mr. McNulty, you were speaking this afternoon concerning letters which you had received from various contract holders; is that correct?

A. Yes.

Q. Was there a single one of those letters which stated that that contract holder was willing that his amount should be reduced to make new capital money available for the [fol. 197] stockholders and directors of the corporation?

A. No, sir.

. . . . . .

[fol. 198] Q. Now, Mr. McNulty, with reference to the letters you received, did the majority of those letters express a desire that the corporation be reorganized and continued in existence, did the majority express the desire that the corporation continue in existence and thereby in time wind up its affairs, or did the majority, if such existed, ask for their money and immediate liquidation of all the assets?

A. Well, that would have to be answered more or less generally because there was no specific interpretation or request, such as you put it, because we have got all kinds of suggestions as to what they think they would like to have happen. We have requests for their cash surrender values; in other cases they have elected to discontinue their pay-

ments until some plan is effected and worked out. It is just a various, large number of different expressions on the part of the contract holders.

Q. I think the Court, and I know counsel, would be interested in whether or not those letters expressed anything in the way that you can relate to us in proportions, even rough proportions, as to the desires of those writing as to whether they wanted their money immediately, whether they wanted [fol. 199] the company to go ahead and slowly wind up its affairs in the natural course of events, or whether they would like to see the company continue on in the same line of business, and if you could give us, not your ideas but your best recollection as to what those letters expressed, I believe the Court and attorneys would find it very helpful.

A. I would hesitate to answer that question because, as I said, there were so many of them that I did not determine or made no effort to determine what percentage.

Q. Would it be fair to say then that the question is one you cannot answer specifically enough to give us any aid?

A. I would say, yes, that is right.

Q. Mr. McNulty, can you give us an idea on this—by an idea I mean your best recollection—Can you tell us what percentage of those letters wanted cash immediately; to get out of the thing immediately; and what percentage wanted something else other than cash immediately?

A. I would hesitate to answer that because I could not say whether it would be 40% or 50%. It is very difficult to give any definite answer on that.

Q. Could you tell us whether there were more letters which expressed a desire for cash immediately than any other plan, or vice versa?

[fol. 200] A. No.

Q. You are unable to answer that question?

A. Yes, because I would not want to make a statement on that for I have not gone into that part of it sufficiently enough.

Mr. Fleming: If the Court please, I understand Mr. Palmer is representing Mr. Sims and the State Receivers; is that right?

Mr Palmer: Yes, sir.

Mr. Fleming: I understand that Mr. Sims and the State Receivers, particularly Mr. Smith, are anxious to bring about reorganization. I was just wondering at your attitude, Mr. Palmer, under the circumstances. I may be mistaken about

that. It seems that Mr. Lauritzen, who is fighting to liquidate apparently the assets in his state purely for the benefit of the contract holders in his state—and I am not criticizing him for that purpose—but it occurs to me there are other people interested in this company outside of, you might say, these two or three states that have this large amount of assets in their possession which they are seeking to liquidate virtually without thought or consideration for the remainder of the contract holders.

Mr. Palmer: If I may be permitted to answer that, the [fol. 201] last questions I asked were at the suggestion of one of counsel for the SEC, and the entire line of questioning was in furtherance of the questions started by you this afternoon, to which I agreed with you and the Court was a proper line of questioning to aid the Court in a determination of the wishes of the contract holders, and in attempting to question the witness here by leading questions on cross-examination I only hoped I might be able to develop the subject a little further than you had been able to do this afternoon.

The Court: The questions seem to be all right but we are not getting very much in the way of answers.

Mr. Palmer:

Q. Mr. McNulty, you stated this afternoon that when the payments of money came in on any particular series of contracts that on your books that money was credited to that series of contracts; is that correct?

A. Yes.

Q. And that thereafter when securities were bought those securities were credited on your books to that particular contract series reserve; is that correct?

A. Yes.

Q. Is it not true, however, that when you sent those securities purchased in that manner to the various states, that they were co-mingled and in a general deposit fund and not [fol. 202] earmarked specifically to any one series?

A. On our records they still remained earmarked for that particular series.

Q. But I am talking about what was done with them by the depository in the state to which they were sent.

Q. Well, I could not answer that question; that depended on the state.

(Question read to the witness.)

The Court: He says he doesn't know.

The Witness: No, your Honor, those securities, as far as our records are concerned, are still earmarked for that particular fund, but when they get to the state depository or whoever has control in the state, whether they co-mingle them or intermingle them, I can't answer that.

Mr. Palmer:

Q. Did you ever inform the state with which you made the deposit that that was to be earmarked for an individual fund and to be held for only such fund, and did you do that with each deposit that you made?

A. I think in recent years that was done, yes.

Q. How about in earlier years?

A. Well, I don't think it was done prior to 1938.

Q. Did you make the deposits with the various states so that you would know the answer to that question?

[fol. 203] A. No, the securities were not handled by me at all; I had nothing to do with that.

Q. Who did that?

A. I imagine Mr. Young, our investment man.

Mr. Palmer: It has been suggested that, the witness not being familiar with that subject, his answers to this should probably be stricken and the questions properly asked of a witness who does know.

The Court: Well, I did not understand him to say he did not know anything about it at all. He just said he was not the one who did it. You may proceed further and if you find he knows nothing about it we will strike his answers.

Mr. Palmer:

Q. Do you know of your own knowledge whether you or someone else in sending the deposits to the various states had each deposit earmarked as being reserved for a particular fund in that state?

A. Well, I believe when the securities were sent out, as I said, after possibly 1939, they were so indicated in the letter of transmittal from Mr. Young. Now, I am not certain on that but as I recall that is the way it was handled.

Q. Can you give us the answer to this, and if not tell us so: whether or not the company borrowed from one fund and put it into another fund; in other words, taking reserves [fol. 204] from Series A in one state and putting it in Series B, and so forth?

A. If that was done as far as the state deposits were concerned?

Q. Yes.

A. No, I cannot answer that definitely.

Q. Can you answer whether it was done on the books of your company?

A. No, I don't think it was done on the books.

Q. Would it be possible for you to answer that? I mean, would you be in position to know the answer to that question correctly or not, or is that just an opinion you have given?

A. As I understand your question, that the deposits as shown by our records belonged to one fund, or the securities belonged to one fund, and were they just taken and transferred to another fund?

Q. No, were they borrowed by one fund from another fund, is the question?

The Court: As I understand, the question is whether on the books of the company there were any loans made from one fund to the other?

Mr. Palmer: That is correct, your Honor.

A. Well, there was indirectly—I wouldn't term it a loan [fol. 205] in that it was an actual transfer. There was an inter-fund loan shown by the books.

Mr. Palmer:

Q. You say there was?

A. Yes, sir.

Q. And was that a frequent practice of the company to make loans, as shown by its books, of the reserves of one fund to another fund when that fund needed it to improve its financial position?

A. Well, prior to 1938 that situaton did exist in that it was created through what we term an overdraft on our books in the bank accounts of the various contract funds.

Q. That was done up until the injunction that was consented to in the SEC suit in Detroit, is that correct?

A. I think several months preceding that time.

Q. Now, Mr. McNulty, this afternoon I was asking you about the investment improvement rate, and if the Court will permit me I would like to make that a little more clear. Is it not a fact that your contract provided that you would return to the policyholder a certain amount of money, a

definite amount, in a certain number of years provided he paid in a certain amount of money per month?

A. Yes, sir.

Q. And did it not further provide that out of the money [fol. 206] he paid in you would set aside a certain part of that which, at a given rate, for instance in the special series, Special Income 5%, would amount to that figure that you were to pay him in the given number of years?

A. Yes, sir.

Q. So that using figures for example, which will not of course make it true, if you agreed to pay him $1,000 at the end of ten and a half years, and he agreed to pay you $10 a month, if your company took $8 per month of that and set it aside, at 5% interest that $8 would amount to $1,000 in ten years. That is what you were doing; is that right?

A. Well, it would be the accumulated reserve, of course, which would give consideration to compound interest on that; yes, sir.

Q. And the same would hold true if the payment were $20 and $8 would be sufficient to meet, at 5% compounded, the final payment; that was all you would have to set aside?

A. That was all that was required by the contract, yes.

Q. And the rest the company had with the exception of the maturity and reserve agreement, which was something else; is that right?

A. That is right.

The Court: Does that mean that the higher the rate of [fol. 207] interest the smaller the amount necessary to be set aside?

Mr. Palmer: Exactly, if the Court please.

Q. So that when the Investment Company Act of 1940 was passed saying that your improvement—your reserve improvement rate could not exceed 3½%, the company did not have sufficient additional assets to set up to meet the requirements so they could make payments; isn't that right?

Mr. Jaegerman: I object to that, your Honor. That is again a legal conclusion. I think they are in error. That applies only to new certificates that might be sold and not to the past business present on the books of the association.

The Court: I will confess it is not very clear to me what it means, but if it is a legal proposition let us have it in the brief rather than in the testimony.

Mr. Palmer: Your Honor, I think, is correct. I thought perhaps the witness could answer as to whether they had sufficient amount of money or securities to meet the requirements of the Investment Company Act of 1940.

The Witness: Well, I can't answer that, in view of Mr. Jaegerman's answer to that question.

Mr. Palmer:

Q. Now, Mr. McNulty, isn't it a fact that the actual yield per dollar the contract holder got on, say, Series B insurance contracts was only 1.55% return on his money?

[fols. 208-212] A. I don't recall the exact amount. It was contained in the booklet but I don't recall the exact figure, and it would depend on the manner of settlement that the contract holder would take.

Q. And isn't it true that if he went through to maturity—I am speaking now of the plan without insurance—the yield to the investor was only 2.56%?

A. Well, I can't answer that as to the accuracy; I think that is approximately correct.

Q. And 1.55 is approximately correct on the Series B where the insurance feature was part of it; is that not approximately right?

A. Well, I can't say, I don't recall whether that is the figure or not. I would say if is approximately correct.

The Court: It would be 1.56 plus the insurance benefit?

Mr. Palmer: No, your Honor, it is 1.56 if the plan went through to maturity whereby they had paid to carry the insurance but the insurance was not needed.

The Court: That is what I am speaking of; but he has had protection during that time of an insurance policy which, if he died, would pay up his contract.

Mr. Palmer: That is right, your Honor.

. . . . . .

[fol. 213] Q. Isn't it a fact, Mr. McNulty, that after the Series B contracts were issued with the insurance feature a large number of your policyholders converted their policies into such type of policy or contract?

A. Well, I don't know what percentage converted their contracts. I know that a number of them did convert the [fols. 214-215] Series B—converted their contracts to the Series B with the insurance.

Q. And it was a large number, was it not, a substantial number?

A. I would say a substantial amount.

Q. Now, you told the Court you had your own opinion, which was partially arrived at from reading letters of the contract holders, that reorganization was the only way that was to the best advantage of the contract holders; is that correct?

A. Well, I did not mean that answer in that I formed that opinion from reading those letters. That is my own personal opinion I formed myself.

Q. And will you state it again, as to what you believe is to the best advantage or for the best advantage of the contract holders?

A. I think a reorganization, definitely.

. . . . . .

[fol. 216] Q. Mr. McNulty, what type plan with reference to capital structure do you have in mind as being a proper or fit one for reorganization?

The Court: All right, you may answer the question.

A. I would say that there is a capital structure with the present company—that there should be additional and new money.

Mr. Palmer:

Q. And you would be opposed to any plan which would take any of the present assets and form a capital structure from those; is that correct?

A. To the detriment of the contractholders, absolutely.

Q. You are not in favor of an immediate or forced liquidation?

A. No, sir.

Q. Are you in favor of a plan whereby the company winds up self-liquidating; that is, the parties who are now contractholders continue to pay in until the end of their terms and the company pays out until the matter winds itself up by virtue of all contracts having ceased to exist?

A. Well, I can't answer that because I have not given [fol. 217] it sufficient study, any particular plan or the best plan.

Q. You would figure that, however, over a forced immediate liquidation?

A. Yes, sir.

Q. And you have not formulated in your mind or otherwise any particular plan other than if there is a reorganization, which you desire to see, there must be new money put in for a capital structure, by someone?

A. Yes, or if some mutual arrangement—I don't know whether that is possible, the legality of it or not.

Q. Mutual arrangement by the contract holders whereby they run the company for the benefit of themselves, you mean; is that right?

A. Yes.

Q. What have you to say as to whether or not this company could reorganize yielding only 2.56% interest on an investor's money, when the Government is now putting out so-called baby bonds yielding 2.99%?

A. Well, in any plan of reorganization some adjustment would have to be made in interest and that would all depend on what conclusions were reached in that respect. I can't answer that now, what method or what rate of interest any reorganized or adjusted policy or contract should contain.

[fol. 218] Q. Is is you belief that a group of persons other than the present group who are and have been running it could manage it better so as to obtain a higher yield on the investor's dollar?

A. Well, that is more or less an investment problem, I don't know——

Q. With which you are not familiar?

A. I am not familiar with that.

Q. Now, Mr. McNulty, other than your own personal desires and wishes do you feel yourself qualified to pass on whether reorganization is possible or probable or likely or should be had?

A. Well, I don't know whether I could—whether I would feel I would want to answer, if that is what you mean, the responsibility——

Q. No.

A. But I think I could contribute; I think I have ideas as to that.

Q. I realize that but my question is whether or not outside of your own personal wishes in the matter you feel yourself qualified from the viewpoint of an expert to say whether there should or should not be a reorganization had in this present matter?

[fol. 219] The Court: He answered that in effect. He said he thought he could contribute to that end.

Mr. Palmer: I think that is sufficient answer then. No further cross-examination.

By Mr. Farmer:

Q. Mr. McNulty, when you were talking about a reorganization of this company, I take it from your subsequent answers that you were contemplating reorganization as an investment company and not as an insurance company?

A. No, that is wrong. As I say, I haven't anything definite; there are any number of ways possibly it could be worked out.

Q. Your mind is just open either way; is that right?

A. Yes, if it can be reorganized I think it should be.

Q. Well, if it should be reorganized as an investment company doing the same type of business that it had done up until December 31, 1940, that would be selling these face amount certificates principally payable on the installment basis, would it not?

A. Yes, sir, as a face amount certificate.

Q. And most of those payments on face amount certificates are made by the contract holders on the installment basis?

A. Yes, sir.

Q. And not just cash lump payments?

[fol. 220] A. No, I am not sure whether that act provides for a lump sum payment or not.

Q. Which act are you talking about?

A. The Investment Company Act.

Q. Well, that provides for both, doesn't it?

A. I think so.

Q. The point I am making is that most of these contracts you make, the people pay in their money on the installment basis and not a lump sum?

A. That is right.

Q. And they pay monthly over a long period of years?

A. Yes.

Q. There has already been, your petition alleges, after December 31, that is, the company did not sell any of that; isn't that right?

A. Yes.

Q. And did not engage in business?

A. No.

Q. And of course that is six months before your petition was filed?

A. Yes.

Q. When you express the opinion that reorganization was feasible did you have in mind that there was very [fol. 221] serious opposition to this jurisdiction of the Court, questions being raised as to whether the Court had jurisdiction to take hold of this old company and try to reorganize it, which might lead to protracted litigation over a period of months or even years?

A. No.

Q. Well, that would have a very important bearing in the ability of the company, if it is reorganized, to pick up and carry on with these people that had been putting their money in it when the company quit, would it not?

A. I imagine so.

Q. In other words, a man after he got "cold" six months or twelve months or eighteen months is going to be hard to get to come back in the fold, isn't that right?

A. I would say time was very essential in the matter, yes, sir.

Q. Those people who put their money in these kinds of contracts are principally people of small means, small investors, that is, and that represents their savings; isn't that right?

A. Well, not——

Q. (Interposing): And a man who is trying to lay his savings away just naturally would turn to some other [fol. 222] place to put them after the thing has been in court for six months or twelve months or eighteen months?

A. Well, I can't answer what he would do.

Q. You could not answer that?

A. Why, no.

Q. Now, if the company is reorganized as one of these face amount certificate companies, you recognized, did you not, that it would have to meet the requirements of the Federal Investment Act and get the approval of the SEC?

A. Absolutely.

Q. And in addition to that you took into consideration, did you, that the company would have to be licensed to do business by these state commissioners in all these various states where it proposed to do business?

A. First? After formulating any plan—I was talking from my own opinion and what I think would be best for the contract holders. I have not gone into any legal end of it at all.

Q. Of course, what the Court is concerned with——

A. (Interposing): But those things would all have to be considered, of course.

Q. Yes, sir; and what the Court is concerned with is whether there is any reasonable prospect of a plan, and not [fol. 223] whether you want it or whether you don't.

A. That is true.

Q. And that would be a very material consideration that would have to be determined right at the beginning, whether this company could get the permission from these insurance commissioners and securities commissioners in all these different states that have authority to license them or keep them out; whether they can get that permission to take up and carry on again, would it not?

A. Yes.

Q. Now, the petition alleges that the company at the time of the filing of this petition in bankruptcy was not licensed in any state, I believe.

A. I am not familiar with the petition; I did not see it.

Q. That is a fact, is it not?

A. We were not operating in any state December 31.

Q. Its license had been revoked in Illinois last year some time, had it not?

A. Yes.

Q. The insurance commissioner out there, and the state officials, revoked it in Illinois?

A. Yes.

[fol. 224] Q. That was a pretty big state; that is, you had sold a lot of contracts out there up to that time?

A. Yes.

Q. So that you have no facts and no information from your study of this problem that would lead you to believe that there was any prospect of getting the approval of the securities commissioners in these different states in which the company has been doing business to give it a license, have you, to carry on again?

A. No, only I believe it is my personal opinion the securities commissioners would consider anything that worked for the benefit of the contract holders, and that is the assumption I have been using.

Q. You said you had communications from several thousand contract holders. Just to get it in the record, I will ask you if you sent out this letter dated July 3, 1941, from the Central Trust Company as one of the communications to contract holders (handing letter to witness).

The Court: Is that a letter from the Central Trust Company?

Mr. Farmer: Yes, sir.

The Court: This man did not send it out, did he?

A. No; it was sent out.

[fol. 225] Mr. Farmer: They undertake to tell the Court about the sentiments of these contract holders, and I wanted to show what type of communications may have been influencing those sentiments, and he said this went out to them, he has identified it in that way, and I would like permission to make it a part of the record and file it as an exhibit.

The Court: I suspect what you are filing there is a letter sent out by the Trustee, which was sent out by the Trustee after a conference with the Court. Is that the letter, Mr. Townsend?

Mr. T. C. Townsend: That is, your Honor.

Mr. Farmer: I am not criticizing anybody; just trying to show what these contract holders got.

The Court: I don't see where you are getting anywhere with this sort of examination, and if we are going ahead at this rate we will be here next week still cross-examining this witness; and I want to get through with him and get out whatever pertinent information you can, but refrain from going into all these matters that don't have anything to do with the issue here.

The Farmer: Does the Court rule I cannot file that letter?

The Court: You may file it.

[fols. 226-227] Mr. T. C. Townsend: It is already in the record but if you want it in again, all right.

Mr. Farmer: I did not know it was in.

Mr. T. C. Townsend: It went out from the Trustee with the permission of the Court.

Mr. Farmer: All right, let it be marked filed as Tennessee Exhibit No. 1.

Tennessee Exhibit No. 1, Filed.

* * * * * * *

[fol. 228] Mr. Farmer:

Q. Now, Mr. McNulty, did you send a certification to the Insurance Commissioner of Tennessee about the amount of the liabilities of that company in Tennessee, to holders of contracts sold in Tennessee, with relation to the deposit of securities in Tennessee?

A. You mean, recently?

Q. No, at any time.

A. Well, it has been done formerly, from time to time. I don't recall the last date.

Q. Did you send it yourself, certify to it yourself?

A. I think I did.

Q. You certified it in September, 1940, did you not?

A. I don't recall the date.

Q. You just certified the liabilities in a lump sum without making any division between Series A, B, C, and D?

A. I don't recall the form now that was sent out.

Q. You don't recall that you did ever send any certification to Tennessee dividing them up into classes like that, do you?

A. Oh, yes.

Q. To Tennessee?

A. Yes.

Q. When?

[fol. 229] A. I think the certification to Tennessee always was broken down as to contract funds, the liability in each fund.

Q. You did that to the Insurance Commissioner of Tennessee?

A. That was my impression, that it was furnished that way, yes.

Q. But you cannot say when that was done?

A. No, but the last one I would say that was sent out.

Q. Was that September of 1940?

A. I don't recall.

Q. Did you ever do that in case of Maryland?

A. I think Maryland was furnished a certification of the liability, yes, by funds.

Q. By series?

A. I think since 1938 they have all—all reports have been shown by funds, by series.

Q. Could you make a search by tomorrow morning and if you can find any such report or certification made by the

company to any of these states dividing up the liabilities into series, produce that?

A. I can't produce it by tomorrow morning. That would be in the records in Wheeling.

The Court: Do you have information it was not done, Mr. [fols. 230-231] Farmer?

Mr. Farmer: All I know, I saw the certification in September, 1940, to the Insurance Commissioner of Tennessee and my recollection is that it is just a lump sum; just said liabilities so much.

Mr. Lauritzen: If the Court please, we have that same information in Wisconsin, up to the last time they made it in Wisconsin they had never, on any occasion, stated where those securities came from or whether they came out of any particular fund or otherwise. It just came out there as a lump sum to be deposited under our laws.

. . . . . .

[fol. 232] Q. There would be no way you know of to make up that deficit unless somebody either put new money in the company or unless you took something away from the class where there was not a deficiency or where there was a small deficiency, trying to equalize it among the others, would there?

A. I have not gone into the point of developing any plan.

. . . . . .

[fols. 233-234] Mr. Farmer:

Q. Mr. McNulty, let me ask you this: you are a stockholder in the company?

A. Yes, sir.

Q. You have how many shares of stock?

A. Thirty-five shares.

Q. And you have been with the company since 1922?

A. Yes, sir.

Q. And you feel attached and devoted to the company?

A. Absolutely.

Q. And you just hope there is some way to reorganize?

A. That is right, yes, sir.

. . . . . .

[fol. 235] By Mr. Lauritzen:

Q. Mr. McNulty, this afternoon you testified that from 1913 to 1935 the sales of the Fidelity contracts were handled by an organization known as the National Sales Agency.

A. Yes; and the firm of Irving & Sisson, for a part of that time, had the right to sell in the Western territory.

Q. Who owned the National Sales Agency?

A. Well, it was, as far as I know, owned by Fred M. [fol. 236] King, A. L. King and I think three or four other stockholders.

Q. Is that the same A. L. King presently a director of Fidelity, or was within recent months?

A. Yes, sir.

Q. Do I understand that company took charge on its own account, hired its own salesmen and conducted the complete sales campaign all over the country during those years?

A. They handled the sales exclusively.

Q. With that other company in part?

A. Yes.

Q. And Fidelity during those years had no salesmen of its own?

A. No.

Q. In 1935 you made a change?

A. It was 1934 or 1935, I am not sure.

Q. And did Fidelity then take on its own salesmen?

A. They were hired by the agency division which was granted for the purpose of operating the National Sales Agency.

Q. Did that company continue to exist as a company?

A. Yes, it continued to exist as a company, I think.

Mr. Palmer: There was a contract between the National Sales Agency and Fidelity Investment Company whereby [fol. 237] National Sales Agency would sell the contracts and receive a certain commission from Fidelity. In order to build up its sales force it borrowed in advance certain money from Fidelity for the purpose of building up its sales force. In time that liability became close to the million-dollar mark, and Mr. Fred M. King, the leading figure of it individually, went into bankruptcy and the National Sales Agency owed Fidelity approximately $1,000,000. In order to liquidate that debt Fidelity kept the National Sales Agency as a going concern and had it hire salesmen and

all the profits made by National Sales Agency went to reduce the deficit owed by National Sales to Fidelity. However, other than having an organized sales company which, of course, is of value to any company, National Sales had no other assets but did have the deficits. Is that substantially correct, Mr. McNulty?

A. That is substantially correct. The agency division operated the National Sales Agency.

Q. After the deficit was discovered?

A. Yes.

The Court: The Fidelity was paying off the debt with its own money?

Mr. Palmer: That was substantially what happened.

The Court: All right.

[fol. 238] Mr. Lauritzen: Mr. McNulty, do I understand then, with the background of Mr. Palmer's statement, that the sales policy of the company after 1935, and up to the time when they went out of business, was determined and originated with the officers of Fidelity?

A. I would say that is substantially right.

Q. Did you have district managers?

A. Yes, sir.

Q. By states?

A. No, by territory. First we had branch office managers, then we had what we called supervisors.

Q. And they got their directions from the home office?

A. From the director of the sales organization, yes.

Q. Who was that?

A. Well, at that particular period it was Carrol D. Evans.

Q. Mr. McNulty, are you familiar with the fact that in the State of Wisconsin, and in numerous other states where Fidelity had a deposit, the sales force of Fidelity was instructed to stress that point in connection with their sales efforts in those states as a representation to prospective buyers that they were fully protected by having a deposit in that state, as to the liability which the company would [fol. 239] incur on the contracts?

A. I was not familiar with the sales policy.

Q. You have no information on that?

A. No, sir; I can't answer that.

Q. Who could give us information on that?

A. Well, I imagine the head of the sales department at that time.

Q. Who was the head of the sales department in December, 1940?

A. Mr. F. H. Pulfer. What date did you say?

Q. December, 1940.

A. Yes, he was the one.

Q. And he had been in that position how long?

A. I think since April of 1940.

Q. Will you tell us who was there before him?

A. Carrol D. Evans.

Q. Where is Mr. Evans now?

A. I think he is located in Wheeling, but he is not with the company any more.

Q. But Mr. Pulfer is?

A. Yes, sir. Well, he is still a director of the company.

Mr. Fleming: I might say Mr. Pulfer is here and will [fol. 240] be a witness for the debtor.

Mr. Lauritzen:

Q. Mr. McNulty, what happened to the sales force of Fidelity in December, 1940, when they ceased selling contracts all over the country, do you know?

A. Well, only from observation, that is all.

Q. Could you give us a general picture of that?

A. Naturally, there was—in December, 1940?

Q. Yes.

A. Well, I think they have just gradually left the company and become associated with other companies.

Q. Now, if this company were to be reorganized and go on in any business of the nature in which it has been engaged during its lifetime, they would have to get a new sales force, that is obvious, is it not?

A. Yes.

Q. In connection with your statement you thought reorganization was in the best interest of depositors, or contract holders rather, have you given any consideration to how long it would take now to build up a new sales force for Fidelity?

A. No, but I would say this, that there would be enough of those salesmen who were interested in the contract holders they sold that if there was a chance to work something [fol. 241] out to their benefit they would come back and represent the company.

Q. You mean, represent them in selling new contracts to new people?

A. Well, or in any capacity that would help the contract holders they had sold. I think they have enough faith in the company to do that.

Q. You mean they might come back and give them information of that sort?

A. No, I think they could be rehired.

Q. And run the business in the same manner as they did before?

A. Well, did I say that? I didn't say that.

Q. You have not given any consideration to this?

A. That is just my personal observation that those men could be obtained, if necessary.

Q. Mr. McNulty, do you know what has been done since the company ceased selling in December, 1940, with respect to the branch offices maintained in various cities in the country?

A. Well, they have been closed.

Q. And what has happened to the equipment in those offices?

[fols. 242-247] A. Well, in some cases I think it was placed in storage; then in other cases I think recently it has been shipped to Wheeling for storage. I don't know whether any of it has been sold or not.

Q. I take it to operate any sort of company such as you had, you would have to secure new leases and open up new offices in a similar manner as the offices existed prior to the time when you ceased selling?

A. I would not say similar, no, sir. I don't think it would be necessary to go to that extent in the branch offices.

Q. You think you could have a less number of offices or something of that sort?

A. Less expensive offices; yes, sir.

* * * * * * *

[fol. 248] Q. In how many states was Fidelity Investment Association qualified to sell its face amount certificates?

A. At any given date?

Q. During the period when you were assistant secretary and later secretary and vice president.

A. I would say some eighteen or nineteen.

Q. At one time you sold in twenty-nine states, did you [fol. 249] not?

A. I think we were licensed in twenty-nine states.

Q. And the business outstanding on the books of Fidelity Investment Association is a face amount certificate business outstanding in some twenty-nine states in the United States?

A. Yes.

Q. And fifteen of those states required deposit of securities; isn't that right?

A. I think that is right.

Q. And the other states did not require a deposit?

A. No.

Q. And for the states that did not require a deposit, a deposit was made in the State of West Virginia?

A. Yes, sir.

Q. With the State Treasurer of West Virginia.

A. Yes, sir.

Q. Now, Mr. McNulty, with what department in these twenty-nine states, where Fidelity Investment Association sold their face amount certificates, did you qualify?

A. Well, in various departments; in some states it was the insurance department, and some the banking commission; others under the securities departments.

[fol. 250] Q. So that the record may be clear, let us go down the list state by state. You sold certificates in Alabama, did you not?

A. Yes.

Q. With what department did you qualify in Alabama?

A. The Securities Commission.

Q. With the Alabama Securities Commission and more particularly the securities registrar, did you not?

A. Well, it was with the Securities Commission; I don't know the title.

Q. Did Alabama require a deposit of securities?

A. Yes.

Q. Do you remember the deposit liability?

A. No, I don't.

Q. I mean requirements. Was not the deposit required to cover the liability to certificate holders in Alabama?

A. Yes.

Q. Certain securities were eligible for deposit; isn't that right?

A. Yes.

Q. And this deposit was made with arrangement with the Securities Commission, as no requirements for a deposit

[fol. 251] were contained in the Alabama securities law; isn't that right?

A. That is my recollection.

Q. And on October 31, 1940 you had a net cash liability of $27,962.31 to contract holders in Alabama; isn't that approximately right?

A. I think that is approximately right.

Q. And you had securities on deposit with the Alabama Securities Commission, with a quoted market value of $30,213,76; isn't that right?

A. I think that is approximately right.

Q. What securities did you sell in Alabama; the Series A, was it not?

A. No, the Series D. That is the only one we sold recently.

Q. What series did you sell prior to Series D in Alabama?

A. I think probably Series A.

Q. Now, let us go to Delaware. With what department of the State of Delaware did you qualify?

A. That was the State Banking Commissioner.

Q. The State Banking Commissioner at Dover, Delaware?

[fol. 252] A. Yes.

Q. What series certificates did you sell there?

A. My recollection is that we sold Special Income—

Q. (Interposing) Let me put it this way: What series did you sell there, and what series are presently outstanding on the books of Fidelity Investment Association, face amount contract certificates?

A. Well, my recollection is that we sold Special Income contracts, the Special Annuity Series A and Special Annuity Series B.

Q. That is right. Now, as of October 31, 1940, your net cash liability to residents of Delaware on the four series you have just mentioned was $291,560.34; is that approximately right?

A. I don't have the exact figures, but I think it is.

Mr. Palmer: It has been suggested that perhaps we could save time, if he has these amounts tabulated, and just put the whole thing into the record, in tabulated form, if the witness can agree to it, because I presume Mr. Jaegerman's figures have been checked, and it might save time to

have it in in that form, and it would probably be helpful to all of us to have it in in a tabulated form, where we could [fol. 253] all use it.

Mr. Fleming: That would be agreeable to the debtor.

The Court: It seems that you can do that. I think you could read off those, and ask the witness if that is correct.

Mr. Jaegerman: I think that would save time.

Q. Now, the quoted market value of your deposited securities in Delaware, as of the same date, was $293,731.88. The date was October 31, 1940, which was the last audited date as prepared by any competent accountant.

Mr. Huwe: Are these figures in the printed report attached to the debtor's petition?

Mr. Jaegerman: I am not familiar with what report was attached to the debtor's petition.

Mr. Fleming: The Haskins & Sells audit was attached to the petition.

Mr. Jaegerman: That is the source of my information as confirmed by various statements.

The Court: Read the whole thing and then the witness can answer as a whole, and these other parties can get their data, then, from the Haskins & Sells report.

Mr. Jaegerman:

Q. Mr. McNulty, in Illinois you sold, or the Fidelity Investment Association sold, Series A and B Income Annuity [fol. 254] contracts?

A. That is right.

Q. And you qualified with the Secretary of State of Illinois?

A. That is right.

Q. And you made a deposit with the State Treasurer of Illinois?

A. Yes.

Q. Now, to go back to Delaware: In Delaware you were required to make an initial deposit of $100,000 in market value of securities, and additional deposits were required to cover liability, and this was required by statute and not by rule or regulation?

A. Yes.

Q. In Illinois the statutes required an initial deposit of securities in amount not less than $50,000, and additional deposits were required to cover liability. The law is applicable to contracts sold since July 7, 1931 and dd not apply

pror to that date. The net cash liability to residents of Illinois, as of October 31, 1940, was $4,284,194.62, and the quoted market value of the securities as of October 31, 1940 was $3,598,632.50.

A. That liability, Mr. Jaegerman, I think that included—[fol. 255] I am not sure, but I think it was calculated there to show the liability before and after July 7, 1931; that is the total of both, I think.

Q. Yes. Now, with respect to Illinois, do you remember, Mr. McNulty, that in March, 1941, I requested you to furnish me with a breakdown of the cash liability in Illinois by series, further broken down as to certificates sold prior to July 7, 1931, and after July 7, 1931, together with the market value of that deposit?

A. I recall that.

Q. Did you prepare that for me?

A. Yes.

Q. Or have it prepared under your supervision?

A. Yes.

Mr. Jaegerman: I want to offer this paper as Exhibit No. 7, your Honor.

Q. Now, Mr. McNulty, I show you what has been marked as Exhibit No. 7, and ask you if you recognize it (handing paper to witness).

Mr. Gray: May I have time to look at those figures, too?

Mr. Jaegerman: Certainly (handing paper to counsel).

A. Yes, I recognize that.

[fol. 256] EXHIBIT NO. 7 FILED

The Court: All right, we will pass on to some other state in which Mr. Gray is not interested, while he examines the exihibit.

Mr. Jaegerman: As a matter of fact, I furnished that information to the State of Illinois, so it is the same as in their records.

Mr. Lauritzen: Were these figures furnished to you by Fidelity?

Mr. Jaegerman: Yes. I think I have developed they were furnished at my request, and prepared under this witness' supervision.

Mr. Lauritzen: And the values shown on there—who is it that arrived at those particular values?

Mr. Jaegerman: I will ask the witness that question.

Q. Mr. McNulty, who prepared the market value that appears on this record? Was this the market value prepared by Mr. Young, or by the State of West Virginia, or internally by the Fidelity?

A. I think that was prepared internally by the association.

Q. And how was it prepared?

A. That was taken from the market quotations of that [fol. 257] date.

Q. From market quotations as of that date, from the Wall Street Journal, Moody's——

A. (Interposing): Yes, the market quotations as of that date.

Q. Probably prepared by C. E. Smith in charge in the investment department at Wheeling, but under your supervision as vice president and secretary of Fidelity?

A. That is right.

Mr. Lauritzen: In offering these they are not offered for the purpose of establishing these values, but only to show that this was a representation that Fidelity made to you as an officer of the Securities and Exchange Commission, at your request; is that right?

Mr. Jaegerman: I offer it for any purpose. It is in evidence as proof for whatever value it may have.

Mr. Lauritzen: If you are offering it for the other purpose, I think it would be improper as being a statement of value, because we have no opportunity to cross-examine the person who made up the compilation, which necessarily must be the result of opinion in some cases, and extended research in others.

The Court: He says they are market quotations. I [fol. 258] don't know how else you can establish market value than that. I will admit it, and overrule the objection. (Exception.)

Mr. Jaegerman: I will just refer to one series, your Honor. This record speaks for itself. The cash liability on income reserve Series B, all sold after July 7, 1931, was $2,840,879.53, while the market value of the deposited securities belonging to Income Reserve Series B is $2,444,950, being approximately $400,000 in excess of liability attributable to that series, while as compared with that we have the cash liability of the Special Income contract, for example, being $160,105.25 and no deposit at all of securities belonging to the Special Income contract funds.

Q. I now refer to the State of Indiana. In Indiana the Special Income, the Special Annuity, Series A and Series B face amount installment investment certificates were issued and sold by Fidelity Investment Association.

A. Yes.

Q. With what department were you qualified in Indiana?

A. Up until, I think, approximately 1934, it was under the Auditor's jurisdiction; then we qualified with the Securities Commission.

[fol. 259] Q. Did you make a deposit in Indiana?

A. Yes, that deposit has been made there. It was one formerly maintained with the Auditor and when we first qualified under the Securities Law, there was *no deposit* required, but later, by a ruling—I think it was a ruling by the commission for a deposit.

Q. That is right. The present law does not require a deposit, but a deposit was maintained to cover liability on contract sold prior to April 1, 1935. The original deposit was $150,000, and additional deposits were required to cover liability. There is a ruling of the department, which required deposit to cover liability on contracts sold after April 1, 1939, but that is not by statute but by ruling of the Securities Commissioner of the State of Indiana.

A. That is my understanding.

Q. As of October 31, 1940, the net cash liability to residents of Indiana was $359,866.83, while the quoted market value of securities deposited in Indiana was $159,971.87. I now go to the State of Iowa. With that department are you qualified in Iowa?

A. There was a dual registration in the State of Iowa. We have not operated in that state for some time. They [fol. 260] are both under the Auditor of the State and the securities department, I think.

Q. And the Insurance Commissioner.

A. I think so.

Q. Charles R. Fisher, Commissioner of Insurance.

A. Yes.

Q. In Iowa you only sold the annuity contract; isn't that right?

A. I think that was right.

Q. And that was sold some time ago; there have been no recent sales in Iowa?

A. No, that is right.

Q. As of October 31, 1940, the Iowa net cash liability was $32,325.08, while the quoted market value of the deposit was $44,696.25, being an excess deposit?

A. Yes, sir.

Q. In Iowa there was a required statutory deposit requirement of $25,000, and then further deposit required to cover liability on all contracts sold in Iowa, and that is by statute, is it not; or is $25,000 the only statutory deposit?

A. I think the deposit we had out there was maintained just to cover the liability, but I am not sure.

[fol. 261] Q. Since your liability here was in excess of $25,000, the $25,000 would apply as initial deposit and the balance to cover excess liability above $25,000?

A. Yes, sir.

Q. I go now to the State of Kansas. In Kansas the Fidelity Investment Association sold the Special Annuity contract and the Series B face amount installment certificate contract?

A. Yes.

Q. With what department did you qualify in Kansas? It was the State Corporation Commission, was it not, the Special Assistant Commissioner?

A. That is right.

Q. As a matter of fact, it was with the Kansas Corporation Commissioner in his capacity as Securities Commissioner; isn't that right?

A. The State Corporation Commission, I think.

Q. Yes, the State Corporation Commission.

A. By the Securities Commissioner.

Q. There are several laws in Kansas, an old law requiring deposit of $50,000 of securities in good standing, and not in default, and additional deposits to cover liability; but under the new law there is no requirement for any deposit. [fol. 262] Now, in Kansas the net cash liability as of October 31, 1940 was $161,272.45, while the quoted market value of the Kansas deposit is only $82,687.50.

A. That is giving effect to the—well, the deposit was maintained there so far as the law required.

Q. Only under the old law, and not under the new law?

A. Yes.

Q. And that accounts in part for the deficiency in the deposit?

A. Yes.

Q. I refer now to the State of Kentucky. In Kentucky the Special Annuity contract was sold and the Series D contract; isn't that right?

A. Yes, I think so.

Q. And in Kentucky you qualified under the Department of Banking and Securities, and more particularly the division of securities?

A. Yes.

Q. And the statutory deposit requirements in Kentucky are $10.000 plus additional deposits to cover liability?

A. Yes.

Q. I am sorry, as a matter of fact that is not a statutory [fols. 263-265] deposit.

A. No, that is by agreement.

Q. That is required by agreement with the securities department of the State of Kentucky?

A. That is right?

Q. And there is no statutory requirement in Kentucky?

A. Not that I know of.

Q. In Kentucky the net cash liability to residents on face amount installment certificates sold by Fidelity Investment Association in Kentucky as of October 31, 1940 was $83,911.07; while the quoted market value of the deposited securities was practically the same, $83,531.25. Now, all the states that I have talked about until now, as far as the measure or the evaluation of deposits of securities were concerned, it was always market value of securities, was it not?

A. Yes, I think that is right.

Q. Whether it was by statute or agreement, the value of the securities offered for deposit was measured by market, and at subsequent periodic valuations was always measured at market; isn't that right?

A. Yes.

Q. And whether required by agreement or statute, that [fol. 266] was the requirement set by the State Securities Commissioners, Banking Commissioners, or whatever officer had charge of that deposit?

A. Yes.

Q. And you, as Assistant Secretary and later as Secretary and Vice President of Fidelity, were charged with the duty of fulfilling those requirements?

A. That is right.

Q. I go now to the State of Maryland. In Maryland, Fidelity Investment Association sold the Special Annuity

contract, Series A and Series B face amount installment certificates?

A. Yes.

Q. In Maryland with what department did you qualify?

A. The Insurance and Banking.

Q. It was both the Insurance Department and the Banking Department?

A. I think that is right.

Mr. Eney: That is not correct.

Mr. Jaegerman: According to my record there was qualification with the Insurance Commissioner and the State Insurance Department.

The Witness: That is right; it was the Insurance and [fol. 267] not the Banking Department.

Q. The Insurance and not the Banking Department?

A. Yes.

Q. In Maryland the law specifies the deposit shall be based on market values and shall be maintained to cover liability with provision that such requirement may be waived upon proof a foreign corporation is maintaining sufficient deposit with its home State. Are you familiar with that?

A. Yes.

Q. Was it waived at any time, do you know?

A. I don't remember.

Q. You don't remember whether it was waived in Maryland at any time?

A. No.

Mr. Eney: The laws says that no deposit shall be required in Maryland if a deposit of 100% of all liabilities is maintained at the home office—at the home state, I mean.

Mr. Jaegerman: Yes, that is what I said.

The Court: With that amplification, all right, let us proceed.

Mr. Jaegerman: In Maryland the net cash liability to [fol. 268] face amount investment certificate holders as of October 31, 1940 was $484,389.90, and the quoted market value of the securities deposited in Maryland as of that date was $466,268.75, which was almost compliance with the requirement. I go on now to the State of Missouri. In Missouri the Special Annuity contract and Series A and

Series B certificates, being installment face amount investment certificates, were issued and sold by Fidelity Investment Association?

A. Yes.

Q. In Missouri qualification was with the Commissioner of Securities, was it not?

A. Under the Secretary of State.

Q. Under the Secretary of State?

A. Yes, sir.

Q. Although there was no specified requirement for deposit in the securities law in Missouri, there was a deposit agreement designating a deposit in the total sum $303,000, and giving the Securities Commissioner the right to accept additional securities through his custodian, with additional deposits to be made from time to time as liability increased.

A. That is right.

[fol. 269] Q. With what department was that deposit maintained, or with what custodian?

A. The Wheeling Dollar Savings & Trust Company, Wheeling, West Virginia.

Q. Mr. McNulty, Mr. Schurr, attorney for the Securities Commissioner of the state of Missouri, informs me that for a time the deposit was maintained in Missouri, but then at the request of the Fidelity Investment Association, that deposit was transferred from Missouri to the Wheeling Dollar Savings & Trust Company at Wheeling, West Virginia. Does that fit with your recollection?

A. I don't recall whether it was originally maintained in the State of Missouri, or not; I could not say definitely. I don't recall whether it originally was deposited in Missouri, or not.

Q. Would there be any one representing the debtor who would have knowledge of that fact, that you could tell us of?

A. Well, it could be ascertained from our records, I am sure.

Q. Apparently some one from the home office?

A. Yes.

Mr. Jaegerman: Your Honor, that is all apparently in [fol. 270] the record in the petition for intervention filed by the Securities Commissioner of Missouri, so I think we can go on.

The Court: All right.

Mr. Jaegerman:

Q. In Missouri, as of October 31, 1940, the net cash liability on face amount installment certificates sold by Fidelity Investment Association in Missouri amounted to $859,451.32 as of October 31, 1940, and the quoted market value of deposited securities was $823.938.12. Now, was it not your practice, Mr. McNulty, as an officer of the Fidelity Investment Association, to furnish the State of Missouri monthly a tabulation of the cash liability and the market value of the deposit against that cash liability?

A. Yes, sir.

Q. Did not you have prepared under your supervision and furnish me some time in March, 1941, with a copy of the Fidelity Investment Association cash liability and the market value of deposit for the State of Missouri, with the Wheeling Dollar Savings & Trust Company as of February 28, 1941?

A. I don't recall.

Q. And was not this report broken down by series, and [fol. 271] furthermore by funds within the series?

A. Yes, sir, I think so.

Q. I show you what has been marked for identification Exhibit No. 8, and ask you whether that is the document or sheet you prepared for me.

A. I think that is the paper.

Mr. Jaegerman: I would like to show this to the representative of the Securities Commission of the State of Missouri, before offering it in evidence (handing paper to Mr. Schurr).

Mr. Schurr: That is all right.

Mr. Jaegerman: The representative of Missouri tells me this is correct, your Honor, and I therefore offer this paper in evidence as Exhibit No. 8.

The Court: All right.

Exhibit No. 8 filed.

Mr. Jaegerman:

Q. Mr. McNulty, referring to Exhibit No. 8, I will refer to just one or two items: the Income Reserve Series A had a cash liability of $55,770.99 as of February 28, 1941, but the market value of deposited securities belonging and allo-

cated to Income Reserve Series A was $119,768.13, while Special Annuity contract had a cash liability of $291,364.42 [fol. 272] with market value of the deposit only $203,060, being a deposit deficiency of approximately $90,000.

I will now proceed to the State of Ohio. In Ohio the Fidelity Investment Association sold the Special Annuity contract, Series A contract and Series D face amount installment investment certificates, which were issued by it. In Ohio, according to my record, qualification was with the Superintendent of Insurance, and deposit was with the Treasurer of the State of Ohio, but there were various intermediate liabilities and I would like to call upon Mr. Dale Dunifon to state that in the record at this time, as he is familiar with it.

Mr. Dunifon: May it please the Court, there was a qualifying deposit of $100,000, put up with the Treasurer of the State of Ohio, and then a deposit was put up with either the Securities Department or the Insurance Department, I am not sure which, at the time the law requiring an additional deposit was made. At the present time that deposit is held by the Superintendent of Insurance, who by virtue of his office is supervisor of bond investment companies and insurance companies. Two separate deposits were made at different times complying with different laws.

[fol. 273] The Court: What is the situation with reference to the liability in Ohio, and the deposits and the different funds securing those liabilities?

Mr. Jaegerman: I think he has the figures on that.

So that Fidelity Investment Association was at various times qualified with the securities department in Ohio, and with the insurance department in Ohio, Mr. Dunifon?

Mr. Dunifon: Yes, sir.

The Witness: I don't think it was the securities department. I think it was the director of the bond investment companies under the Bond Investment Act.

Mr. Dunifon: If the Court please, the Director of Commerce was given authority to designate one of his assistants, either head of the building and loan department, head of the department of insurance or head of the department of banking or the head of the department of securities as Bond Investment Commissioner, and that was changed—that was changed as different Directors of Commerce came in office, you understand.

Mr. Jaegerman: So that the person or agent with whom qualification was made in the first instance was the Bond Investment Commissioner?

[fol. 274] Mr. Dunifon: That is right.

Mr. Jaegerman: In Ohio a statutory deposit of $100,000 was required. Deposit is required to cover liability on contracts sold from the effective date of the law which was April 13, 1939, but the law provides for a deposit to cover liability on all contracts sold prior to the date of the law, on or before March 1, 1940, before receiving a certificate of authority, and it was because of Fidelity Investment's failure to comply with this retroactive deposit requirement that no certificate of authority was issued after March 1, 1940, and after that date Fidelity no longer sold any certificates in the State of Ohio. However, it continued to service face amount installment certificates sold prior to March 1, 1940, and still continues under the receivership to service those certificates.

In Ohio, as of October 31, 1940, the net cash liability to face amount investment certificate holders who purchased certificates from Fidelity Investment Association, was $2,346,326.88, while the quoted market value was only $487,346.57, indicating a very substantial deficiency in the deposit, which was due to that retroactive nature of the law.

The Witness: Yes, sir.

[fol. 275] Q. Mr. McNulty, I go now to the State of Pennsylvania. In Pennsylvania Fidelity Investment Association sold Special Income, Special Annuity, Series A and Series B face amount installment investment certificates.

A. I think in some few instances also Series D contracts were sold in Pennsylvania, too.

Q. But those were—

A. (Interposing) More or less isolated sales, yes.

Q. More or less isolated sales which resulted from their proximity to Ohio, where you were selling a Series D certificate?

A. Adopted principally for Schuylkill County, Pennsylvania, on account of that insurance.

Q. In Pennsylvania you qualified with the State Securities Commission, did you not?

A. Originally it was the banking department, I believe. That law was changed and supervision was changed.

Q. At one time you qualified with the banking department in the State of Pennsylvania and subsequently and

presently with the State Securities Commissioner at Harrisburg, Pennsylvania?

A. Yes, sir.

Q. That is right, is it not?

[fol. 276] A. Yes.

Mr. Jaegerman: I see Mr. Scott is here representing the Pennsylvania Securities Commission. May I inquire if what I have said is true, Mr. Scott?

Mr. Scott: That is right.

Mr. Jaegerman:

Q. In Pennsylvania a statutory deposit of $100,000 is required by Acts of 1933, Section 7?

A. I think that is right.

Mr. Jaegerman: Your Honor, I think I should read that in evidence, because there is some peculiar wording.

The Court: All right.

Mr. Jaegerman: (Reading) "The commission may require every corporation licensed under the provisions of this act, to set apart a fund, no portion of which shall be applied to the expense of such corporation, which shall consist of not less than 10% of the amount designated in each contract issued as applicable to the payment of the expenses of conducting the business of such corporation."

Q. You are familiar with that statute, are you not?

A. I think that is right, yes.

Q. In Pennsylvania the net cash liability was the highest of any other state, was it not, Mr. McNulty?

A. I think that is right.

[fol. 277] Q. It amounted in October, 1940, on October 31st, to $4,748,886.63, while on that same date the market value of the deposit was only $229,229.38, leaving a deposit deficiency in excess of four and a half million dollars.

A. Yes.

Q. I now go to the State of Tennessee. In Tennessee Fidelity Investment Association sold the Special Annuity contract and Series B installment face amount investment certificates?

A. Yes.

Q. In Tennessee qualification is with the Department of Insurance and Banking; isn't that right?

A. Yes.

Q. And there is no statutory requirement for deposit in Tennessee, is there?

A. Not to my knowledge.

Mr. Tipton: Your Honor, that is not accurate. There was a statute passed in 1939, which requires 100%. I have the original act in my possession here.

Mr. Jaegerman: Was that statute retroactive?

Mr. Tipton: Yes, sir.

Mr. Jaegerman: If you have that statute will you offer it in evidence at this time?

[fol. 278] Mr. Tipton: I don't have it here; it is in my room in the hotel, part of a volume of acts, but I can read it into the record, if you wish.

Mr. Farmer: I have a copy here. It is pretty long, however.

Mr. Gray: While on that subject, I object to this witness giving his version of the law of Illinois. I would just as soon the Court would take judicial knowledge of our statutes. I would like to offer the securities law of Illinois, if the Court please, as an exhibit in this case.

The Court: That would probably be better, yes.

Exhibit No. 9 Filed

Mr. Palmer: If I understand, this is not an attempt by Mr. Jaegerman to expound the law of any of these states, but it is a statement of fact to which the laws of the states would be applicable as furnished to your Honor by the various attorneys under the agreement this morning.

The Court: That is true, but the more accurate they can be right here, the better.

Mr. Jaegerman: What I am offering now is not my idea of the law, your Honor, but the idea of the responsible officers of Fidelity Investment Association, their description or understanding of the law as they understood it to apply to them; and therefore I believe it is relevant.

[fol. 279] Mr. Gray: Well, we would rather the Court took judicial knowledge of our statutes.

The Court: It is all right to put it in this way, however, but when it comes actually to applying the law, it will be applied according to the way it is written.

Mr. Palmer: That is my understanding, that Mr. Jaegerman is putting in facts and not attempting to put in the exact law, but the law will be drawn by the Court from his judicial knowledge furnished by the statutes.

Mr. Jaegerman:

Q. In Tennessee, Mr. McNulty, there is existing an agreement, dated November 19, 1938, covering a deposit of $125,000, with provision for additional deposit to cover liability. The liability is to be determined every six months from the date of the agreement, no valuation basis specified in the agreement, no specific requirement relative to deposit in the law prior to the passage of the act mentioned by the representative from Tennessee, but market values were used as the basis for deposit for evaluation by the Tennessee department; isn't that right?

A. Yes. I might say that deposit agreement has been superseded by—with assignment of the securities there and refers to the new statute that was passed.

[fol. 280] Q. And when was that statute passed?

A. It was in 1939.

Q. In Tennessee as of October 31, 1940, the net cash liability to residents of the State of Tennessee, resulting from the sale of the face amount investment certificates there by Fidelity was $177,947.11, while the deposit, or the market value of deposited securities, was in excess of that amount, or $190,300.

The Court: How many more states do you have, Mr. Jaegerman?

Mr. Jaegerman: Just three.

A. That is right.

Q. In Virginia Series A and B and the Special Annuity contracts were issued and sold by Fidelity Investment Association, being face amount installment investment certificates, and qualification was with the State Corporation Commission?

A. That is right; yes, sir.

Q. And the statutes of Virginia required a deposit of $25,000 in lieu of bond.

A. That is right.

Q. The evaluation was on a fair market value in Virginia, and the net cash liability to residents of the State [fol. 281] of Virginia resulting from the installment face amount certificates, issued by Fidelity Investment Association, amounted as of October 31, 1940, to $525,201.13, while

the market value of the deposit was only $27,250, leaving a deposit deficiency of about $500,000.

A. Yes.

Q. In Wisconsin Series A and Series B were sold by Fidelity Investment Association, and in Wisconsin qualification was with the State Treasurer of Wisconsin.

A. No.

Q. With whom, then?

A. The Banking Commission.

Q. Qualification was with the Banking Commission of Wisconsin and deposit was with the State Treasurer of Wisconsin?

A. Yes.

Q. In Wisconsin there was a statutory requirement, was there not?

A. Yes, sir.

Q. And the deposit is required to cover liability to the extent of 110% of the cash surrender value.

Mr. Lauritzen: The statute does not use the term, "cash surrender value", but in making their deposit the company [fol. 282] has used the term "net cash liability", whatever that means.

Mr. Jaegerman: The statute requires deposit to cover liability to the extent of 110%, and in practice Fidelity has certified a net cash surrender liability to the State of Wisconsin and against which a deposit was made.

Mr. Lauritzen: Not "surrender"; just net cash liability.

Mr. Jaegerman:

Q. What was that net cash liability?

A. That would be the same as the cash surrender value.

Q. And that is what the company used, is it not?

A. Yes, in that connection that 110% of liability—I think it was their ruling that when the securities, the valuation of securities was 90% of the total liability, then additional securities would have to be made which made it really more than 110% of the liability.

Q. Yes. In Wisconsin, as of October 31, 1940, the net cash liability was $2,287,427.24, while the market value of deposited securities was in excess of that amount, or $2,496,541.89.

A. Yes.

Q. And now finally the State of West Virginia also had a statutory deposit requirement, did it not?

[fol. 283] A. Yes.

Q. In the State of West Virginia the Special Income and the Special Annuity contracts were sold, as well as the Series A and B face amount installment investment certificates; isn't that right?

A. In some few instances Series D contracts were sold, too.

Q. That would be scattered instances?

A. Yes.

Q. With what department did you qualify in the State of West Virginia?

A. In the insurance department.

Q. With the Auditor as Ex Officio Insurance Commissioner of the State of West Virginia?

A. Yes.

Q. Prior to December, 1940, was it not your understanding that that qualification was with the securities division of the Auditor's office?

Mr. Palmer: I object to the witness' understanding as to that. I think the statutes of West Virginia speak for themselves, where the required qualification need be, rather than this witness' interpretation of those statutes.

The Court: His understanding may be pertinent also.

[fol. 284] A. Well, as I say, we are under the Auditor and, as Ex Officio Insurance Commissioner, in some instances or some cases matters would be referred to Mr. Brown.

Q. And prior to December, 1940, Mr. Brown had charge of the affairs of Fidelity, rather than Mr. Justice, who has charge of the insurance companies?

Mr. Palmer: I object.

The Court: Overruled. (Exception.)

A. I don't know what they did down there.

Mr. Jaegerman:

Q. Did you personally have any dealings with the office of the State Auditor of West Virginia?

A. In some few instances in making a substitution of securit[illegible], I would secure his approval for the substitution.

Q. In those instances, what individual did you see and what individual transacted your business with you?

A. I think I called on Mr. Brown.

Q. Mr. Robert Brown?

A. Yes, sir.

Q. What was his title?

A. Deputy Securities—well, I am not sure.

Q. Deputy Securities Commissioner?

A. I think that was his title.

[fol. 285] Q. It was Deputy Securities Commissioner of the State of West Virginia?

A. Yes.

Q. Are you familiar with the license that the Fidelity Investment Association had from the then Auditor of West Virginia, prior to December, 1940?

A. Yes, sir.

Q. Under the statutes of West Virginia, in addition to the liability on certificates sold in West Virginia, deposit was required against liability on certificates sold in all other states which did not have a deposit requirement; isn't that right?

Mr. Palmer: If the Court please, that is a direct question of what is the statute of West Virginia, and I think this witness is not one qualified to give that statute unless——

Mr. Jaegerman: Pardon me, but what I am asking is his understanding, and the practice he followed as a responsible officer of Fidelity.

The Court: The objection is overruled. (Exception.)

Mr. Palmer: Certainly the question does not say what is the statute.

The Court: If the question does not say that, it is just [fols. 286-289] this witness' understanding, and the Court will be governed by the statute, itself.

Mr. Jaegerman: I will reframe the question, your Honor.

Q. In making the deposit with the State of West Virginia, what was your understanding as to the measure of deposit liability, as required by the State's statute?

A. Well, it was in addition to the statutory requirement, it was to cover 100% of the cash liability on all contracts, you might say, credit for deposits maintained in other states.

Q. And did the company follow that requirement as you have explained it?

A. Yes, that was the method used.

[fol. 290] Mr. Jaegerman:

Q. Mr. McNulty, yesterday we went through the various states which, either by statute or by agreement, required Fidelity Investment Association to make deposit of securities with the state, and I show you what I have had marked for identification as Exhibit No. 10, and ask you whether you can identify it.

A. Yes, this information was furnished you.

Q. This was information furnished me at my request by the Fidelity Assurance Association, cash liability and deposit for the State of Wisconsin, February 28, 1941, broken down as to cash liability by series and by funds within the series, and the market value of deposit of securities belonging to the various series and funds; is that right?

A. Yes, sir.

[fol. 291] Q. Was this prepared under your direction pursuant to my request?

A. Yes, sir.

Mr. Jaegerman: I show it to Mr. Lauritzen, representing the State of Wisconsin (handing paper to counsel).

Mr. Lauritzen: I think that is correct, Mr. Jaegerman.

Mr. Jaegerman: We offer this in evidence as Exhibit No. 10.

Exhibit No. 10 Filed

Q. Mr. McNulty, referring to several of the figures appearing on this Exhibit No. 10, it appears that the cash liability of Special Annuity Fund was $375,355.10 and the market value of the deposit of securities belonging to the Special Annuity Fund was only $238,730.01, being a deposit deficiency, as applied to that fund, while Special Annuity M. & R., which was maturity reserve for Special Annuity contracts, had a cash liability of $26,628.97, and no securities belonging to that fund were on deposit with Wisconsin; is that right?

A. Yes, sir.

Q. On the other hand, Income Reserve Series A had a cash liability to residents of Wisconsin of $178,567.43; is [fol. 292] that right?

A. Yes, sir.

Q. And the market value of securities belonging to Income Reserve Series A Fund was $506,151.26.

A. That is right.

Q. Being an excess deposit of securities belonging to that fund of approximately in excess of $300,000?

A. Yes, sir.

Mr. Jaegerman: Your Honor, yesterday you asked me whether I could break down that West Virginia deposit and liability, which was an accumulative one of the various states. I am having that prepared at Wheeling, West Virginia, and the information will be telephored in some time this morning.

The Court: All right.

Mr. Jaegerman: I want to make one correction of my question yesterday. I inferred that the $7,029,994.59 of the net cash liability shown for West Virginia would be applicable to contracts sold in West Virginia. Is that correct, Mr. McNulty?

A. No.

Q. What is the correct answer to that?

A. Well, that would include the liability in states in [fol. 293] which no deposits were maintained or required.

Q. Or liability in states where the deposit maintained was insufficient to cover the full liability?

A. Yes.

Q. What approximately was the actual liability in West Virginia applicable to certificates sold in West Virginia?

A. Well, I could not say exactly; approximately $2,000,000.

The Court: I don't believe I understand this last question or two, Mr. Jaegerman. Altogether in West Virginia there was better than eleven million dollars?

Mr. Jaegerman: Yes, your Honor, eleven million, three hundred thousand.

The Court: Now, there was a margin of better than four million dollars that was applicable to contracts sold in other states where there was no deposit, was there not, or what is that four million for?

Mr. Jaegerman: You are referring, your Honor, to the seven million dollars net cash liability, and the eleven million dollars quoted market value of securities on deposit?

The Court: Yes.

[fol. 294] Mr. Jaegerman: That would leave a round four million dollars surplus, but actually if one compares the value of the securities deposited in other states with the liability in those states, the deficiency is substantially in excess of four million dollars.

The Court: This four million dollars, then, is to cover the deficiency in states where deposits are required; is that right?

Mr. Jaegerman: This deficiency is due to the fact that the deposits in West Virginia were made at book value, and not at market value, and the shrinkage between book and market values accounts for the deficiency.

The Court: I want to know what that spread of four million that we have in West Virginia as of that date is applicable to.

Mr. Jaegerman: Your Honor, of the seven million liability figure, which I gave for West Virginia, two million is applicable to contracts sold in the State of West Virginia, and five million is applicable to states in which certificates were sold, but no deposits at all were made.

The Court: Now, what about the extra four million between that and the eleven million, the difference between the seven million and the eleven million, or the four million [fol. 295] dollars; what about that?

Mr. Jaegerman: Your Honor, the difference between the seven million and the eleven million, or the four million dollars, is applicable to states which required a deposit, but where the deposit was insufficient to cover the liability on those states requiring deposits.

The Court: All right; that is what I wanted to know.

Mr. Lauritzen: Mr. Jaegerman, do I understand there is some segregation made of the West Virginia fund, as to what the two million dollars is for, and what the five million dollars is for, and what the four million dollars is for, or is that your own or the company's breakdown of those figures?

Mr. Jaegerman: I understand Auditor Sims is under subpoena, and that certainly is one of the questions we will ask him when he takes the stand. The figures I gave, of course, are from the certified audit prepared by the auditors retained by the Fidelity Assurance Association.

Mr. Lauritzen: The only facts you have on that point are as shown in the compilation of the Haskins & Sells audit of 1940; is that right?

Mr. Jaegerman: No, plus information furnished by the company and obtained by me in my investigation.

[fol. 296] Mr. Lauritzen: Have you got that information here?

Mr. Jaegerman: You mean the additional figures?

Mr. Lauritzen: Yes.

Mr. Jaegerman: As explained to the Court, I have requested the employees in Wheeling to give me a tabulation, which should be here today, and which I will offer in evidence. Perhaps we could reserve an exhibit number for that right now, your Honor.

The Court: All right, you may do that.

Mr. Jaegerman: Very well, that will be Exhibit No. 11, which will be a statement of the net cash liability in states which do not require a deposit of securities, and that figure will be as of October 31, 1940, which was the latest audit taken.

(Exhibit No. 11 To Be Filed)

Mr. T. C. Townsend: That is four million dollars?

Mr. Jaegerman: No, it will be approximately five million dollars, but I cannot give you the exact figure, Mr. Townsend.

The Court: All right; let us proceed.

Mr. Jaegerman:

Q. Mr. McNulty, I want to go into the question of the states in which Fidelity Investment Association sold face amount installment certificates, where no deposit of securi-

[fol. 297] ties were required. Were you qualified in Arkansas.

A. Yes.

Q. Did you not sell the Annuity Contract in Arkansas?

A. Yes.

Q. With what state commission or department did Fidelity Investment Association qualify?

A. The Arkansas Railroad Commission, as I recall.

Q. And it was the Securities Division of the Arkansas Railroad Commission?

A. Well, I know it was the Railroad Commission, I don't know whether they had a division there or not.

Q. Mr. McNulty, did not Fidelity Investment Association sell the Special Annuity, the Special Income, the Series A

and the Series B face amount installment investment certificates in the District of Columbia?

A. That is right.

Q. Was registration or qualification necessary with any agency there?

A. No.

Q. Mr. McNulty, did not Fidelity Investment Association sell the Annuity Contracts, face amount installment investment contracts, in Florida?

A. Yes.

[fol. 298] Q. With what department was Fidelity registered there?

A. The Securities Commission, as I recall.

Q. Mr. McNulty, did not the Fidelity Investment Association sell the Series A, and the Series B face amount installment investment certificates in the State of Georgia?

A. Yes, it did.

Q. With what department in Georgia did Fidelity qualify?

A. I think it was with the Securities Division or Securities Commission; I don't recall the exact title.

Q. Mr. McNulty, did not Fidelity Investment Association sell the Special Annuity Contract and the Series B contract in Louisiana?

A. I am not certain about the Annuity Contract. It did sell the Series B, I know.

Q. With what department in Louisiana did Fidelity qualify?

A. The Securities Department.

Q. Did not Fidelity Investment Association sell the Special Annuity, the Series A and the Series B installment face amount certificates in Michigan?

A. Yes, sir.

Q. With what department in Michigan did Fidelity [fol. 299] qualify?

A. The Department of Insurance.

Q. Did not Fidelity Investment Association sell the Special Annuity Contract in Mississippi?

A. Yes, it did.

Q. With what department in Mississippi did Fidelity qualify?

A. I think we qualified there under the Secretary of State. I don't know whether they had a Securities Division or not, but it was with the Secretary of State.

Q. Did not Fidelity Investment Association sell the Special Annuity Contract in the state of Maine?

A. Yes, they did.

Q. With what department in Maine did Fidelity qualify?

A. I think that was with the Department of Banking.

Q. The Department of Commerce, wasn't that the name?

A. I think so.

Q. And more particularly the Commissioner of Securities in the Department of Commerce?

A. I think so.

Q. Was the Special Annuity contract sold in the State of New Jersey by Fidelity?

A. I think it was, yes.

[fol. 300] Q. Was there qualification in New Jersey?

A. Yes, we were qualified there under the Department of Insurance and Banking.

Q. Sales were discontinued after Fidelity Investment Association's wholly owned subsidiary, Fidel Association of New York, Inc., was qualified to do business?

A. That is right.

Q. Mr. McNulty, did not Fidelity Investment Association sell the Special Annuity Contract in North Carolina?

A. Yes, sir, it did.

Q. With what department in North Carolina was qualification obtained?

A. The Securities Department.

Q. Did not Fidelity sell the Special Annuity face amount installment investment certificates in North Dakota?

A. Yes, it did.

Q. With what department was qualification obtained?

A. With the Securities Department.

Q. Mr. McNulty, did not the Fidelity Investment Association sell the Special Annuity Contract and the Series A contract in Oklahoma?

A. Yes.

Q. With what department was qualification obtained?

[fol. 301] A. With the Securities division or department. Now, I am giving you these departments from memory, as I remember them. I cannot be certain of the exact title of them.

Q. Was the Oklahoma Securities Commissioner the securities division of the State Banking Department?

A. I think that is right.

Q. Mr. McNulty, did not the Fidelity Investment Association sell the Special Annuity investment certificate in South Dakota?

A. It did.

Q. With what division was qualification obtained?

A. As I recall it was the securities division or Securities Department.

Q. Finally, did not Fidelity Investment Association sell the Series B certificates in South Carolina?

A. Yes, it did.

Q. With what department in South Carolina was qualification obtained?

A. With the Department of Insurance through the secretary of the Securities Commission or division; I don't recall the exact title.

Mr. Jaegerman: As explained, your Honor, we will have, [fol. 302] I think, today the net cash liability as of October 31, 1940, in these various states where no deposits were required and on which deposit was maintained with the State of West Virginia.

The Court: All right.

Mr. Jaegerman:

Q. Now, Mr. McNulty, at various times did not representatives of the state agencies, with which Fidelity was qualified, visit Wheeling, West Virginia?

A. Yes, sir.

Q. And was it not part of your duties to see that their wants were satisfied and any questions they might have would be answered?

A. Yes, sir.

Q. When these representatives of the various state departments visited Wheeling, were they permitted to examine the various books and records of Fidelity Investment Association maintained by it at its home office?

A. Yes, sir.

Q. And did not they, in fact, examine these books and records?

A. In most instances they did.

Q. And you were present when they examined them, and you answered questions that might have been asked you by [fol. 303] them, or you made available other members of

the staff who could answer detailed questions on accounting and bookkeeping?

Mr. Schurr: Your Honor, I object to this type of examination unless they specify what states and persons had conversations with him and which ones inspected their books and records at Wheeling. We don't want that to mean that Missouri is involved in such procedure as that.

Mr. Jaegerman:

Q. Well, let us take the State of Missouri. Did not, from time to time, representatives of the State of Missouri visit the home office of Fidelity Investment Association at Wheeling, West Virginia?

A. Yes, representatives of Missouri have been in Wheeling.

Q. And did not representatives of the State of Wisconsin visit Wheeling?

A. Yes, sir.

The Court:

Q. And did representatives of Wisconsin and Missouri look over the books?

A. I know the representatives from Wisconsin did definitely; and as to Missouri, that was more or less of a discussion or a conference.

Mr. Lauritzen: Would you bring out when these visits [fol. 304] took place, Mr. Jaegerman, on the part of Missouri or Wisconsin officials to Fidelity?

Mr. Jaegerman:

Q. Did not representatives of the State of Illinois visit the home office of Fidelity Investment Association at Wheeling, West Virginia?

A. I don't recall Illinois.

Q. What other states, if any, do you recall had representatives visit the home office of Fidelity Investment Association at Wheeling, West Virginia?

A. Virginia, Tennessee, Iowa—those are all I can recall offhand.

Q. Ohio.

A. Oh, yes, Ohio.

Q. To the best of your recollection, Mr. McNulty, will you please identify the approximate time or times as to these various visits by representatives of the states you have mentioned?

A. Well, the states of Wisconsin, Virginia and Tennessee in June, 1939. They conducted an examination then. The State of Virginia was more recently, about in March, I would say.

The Court:

Q. What year?

A. March of this year. I am not certain on Ohio. I think [fol. 305] the last time they were there was about, possibly, two years ago.

Mr. Jaegerman:

Q. These other dates, were the dates of the last visit?

A. The dates on which I feel certain an examination of the books was made on their visit there is Wheeling.

Q. And with which you are famiilar?

A. Yes.

Q. Ohio was down some time in the summer of 1938; isn't that right, at the same time the representatives of the Securities and Exchange Commission were there?

A. Yes, sir, they were.

Q. How about West Virginia? Did they have representatives visit the office?

A. Well, on some occasions they did visit there, although the audit report there was taken as an examination.

Mr. Lauritzen:

Q. I did not hear you.

A. The audit report was used by West Virginia in place of a real examination themselves, although at various different times in past years, they have had their representative participate in the annual audit.

Mr. Jaegerman:

Q. You mentioned an audit report, Mr. McNulty, what audit report was that?

[fols. 306-324] A. The annual audit report conducted by the auditors hired by the association.

Q. And the auditors that were hired, did that hiring take place after conferences with the State Auditor of West Virginia?

A. On several occasions it did.

Q. It was an anditor that was approved—in some instances, then, the choice of independent public certified accountants to conduct the annual audit was approved by the Auditor of the State of West Virginia?

A. That is right; yes, sir.

Q. Did not the Anditor at one time make an independent examination of Fidelity back in 1932 or '33?

A. Well, he did engage a firm, an auditing firm from Charleston or Huntington to participate with the auditing firm that the association had hired.

. . . . . .

[fol. 325] Mr. Jaegerman:

Q. You are familiar with the way the books and records of Fidelity are kept, are you not?

A. Yes, sir.

Q. With respect to the segregation by funds and by series?

A. Yes, sir.

Q. And with the fact that securities are purchased with moneys that are allocated to the particular funds, and the securities, in turn, are allocated to these funds and series?

A. Yes.

Q. And that information is clearly set forth on the books and records of the company; is it not?

A. Yes, sir.

Q. Now, the various state officers who visited the office of the Fidelity were permitted to see these various books and records, were they not?

A. They were permitted to see anything—to see any and all records.

Q. And in fact that was the purpose for which they came [fol. 326] to the office of Fidelity, as explained to you?

Mr. Schurr: I object to that question; unless it is made more definite and certain, and not such a general question. Let him specify whom and the time.

Mr. Jaegerman: The witness has already specified exactly what states had representatives at the office of Fidelity, and the various dates on which these visits were made.

Mr. Schurr: No, he has not.
The Court: The objection is overruled.

(Exception.)

A. Yes, to determine the general financial condition and also to check on the deposit of securities for the liability.

Mr. Jaegerman:

Q. And on occasions you explained to these representatives what we might describe as the fund theory or the series——

Mr. Lauritzen: I object.
Mr. Jaegerman: I will withdraw the question.
Mr. Lauritzen: You say he has stated just when these people were there? I don't think he has done that.
Mr. Jaegerman: You can bring that out on cross-examination.
Mr. Gray: That question is decidedly leading, if the [fol. 327] Court please.
The Court: Well, it has been withdrawn.

Mr. Jaegerman:

Q. Mr. McNulty, perhaps we will save time if you will make a statement of the general business as conducted by Fidelity Investment Association, the manner in which the business was conducted.

A. Well, it was engaged in the business of issuing and collecting payments on installment savings, what I would term an installment savings contract, calling for certain stipulated monthly payments over a period of months or years, at which time the contractor at maturity had the option of taking a lump-sum settlement or an annuity for a certain number of years. In fact, the type of settlement was optional with the contractholder.

Mr. Palmer: May I ask if that is not true only up to 1940, that after that time the business of the company was changed?
Mr. Farmer: Isn't this repetition? I thought I heard it yesterday. I know Mr. Fleming went into a lot of things about the contracts.
Mr. Jaegerman: We are not going into the contracts, but the conduct and nature of the business, which is highly im-

portant and relevant to the questions raised in the plead-
[fol. 328] ings.

Mr. Farmer: I object on the ground of repetition.

The Court: Overruled.

(Exception.)

Mr. Jaegerman:

Q. Until December 31, 1940 Fidelity Investment Association was engaged in issuing and selling installment investment certificates, face amount certificates; isn't that right?

A. That is right.

Q. That is the only type of certificate or investment that was being issued and sold by Fidelity Investment Association; is it not?

A. That is right.

Q. After that date did the company sell anything at all?

A. Not after December 31, 1940.

Q. After that date did the Fidelity Investment Association engage in any business whatsoever?

A. No, they did not.

Q. After that date did not Fidelity Investment Association only continue servicing the face amount certificates that had been issued and sold prior to that date?

Mr. Palmer: I object. I don't believe the purpose of that question is quite fair, in that the corporation had a
[fol. 329] right to do certain business after that time, and whether they engaged in it or not, of course, is also a matter of proof. They had a right to engage in other business.

The Court: This should be brought out by this witness.

Mr. Reinhardt: Your Honor, I think that is proper on cross-examination. As a matter of fact, I would like to observe that the examination of this witness has been peppered with a great many interruptions, many of which relate materially to what should properly be brought out on cross-examination. We are not objecting, but we are now endeavoring to present a full picture of this case, and we would like to present it in the manner we think would be most helpful to the Court. Any additional information which other counsel believe would be helpful, I think should properly be brought out on cross-examination.

The Court: Let us get along with it and expedite the examination as fast as we can.

Mr. Jaegerman:

Q. The installment investment certificates, sold by Fidelity prior to January 1, 1941, called for periodic payments to Fidelity, did they not?

A. They did.

[fol. 330] Q. Monthly?

A. Monthly, quarterly, semi-annually or an annual payment for a certain number of years or months.

Q. Now, Mr. McNulty, trace the handling of these payments as they were received.

A. Well, practically the large percentage of payments received were received by mail, and in some cases received in the branch offices or in collection banks, which acted as collection agencies, which in turn was transferred to the home office at Wheeling. The payments, when received there, would be allocated on the books to the proper account, the distribution of the payment as to the commission payments.

Q. That would be selling commissions?

A. Yes.

Q. What would other accounts be?

A. Well, in Series B would be the allocation for the insurance premium and for the amount necessary to the reserve and the contract holder's particular account was credited with that payment, and the money then was deposited in a bank account in whatever particular series that money was received, which in turn was used for investment purposes as the investment committee saw fit.

[fol. 331] Q. What was the mechanics of investment?

A. Well, that would be handled by the investment committee upon recommendation of the investment experts, or counsel employed by the association.

Q. Who maintained offices in New York City?

A. Yes, sir.

Q. He would make certain recommendations to the investment committee, which would either approve or disapprove those recommendations?

A. Yes, sir.

Q. If those recommendations were approved, then what happened?

A. Well, the investment man would proceed with the purchase of securities and the securities would then be possibly held for safe-keeping, maybe, for a time or deposited with any one of the various state departments.

Q. When a purchase was made, how was it paid for?

A. Well, it was charged to the—paid for in cash.

Q. Where was that cash; where did you get the cash?

A. They accumulated it from the payments made by contract holders to the association.

Q. And it was cash that would belong to one particular fund; is that right?

[fol. 332] A. Well, to any one of the various funds. That would be held separate for that particular fund.

Q. And the purchases that were made would be purchases that would be allocated to the fund from which the cash was derived?

A. Yes, sir.

Q. And what was done with the securities after they had been purchased and after they were no longer being held in safekeeping?

A. They were deposited with the State of West Virginia, or any other state where an additional deposit was required or requested.

Q. Would a letter of transmittal accompany these securities that were sent to the various states for deposit?

A. Well, I have seen copies of letters. I did not handle that particular end of it.

Q. Who did handle that?

A. Mr. Hubert Young of New York.

Q. Did you have a department in connection with cash surrenders or maturities?

A. Yes, we maintained a department in the Wheeling office for that particular end of it.

[fol. 333] Q. When a request for cash surrender came in, what would be done?

A. Well, of course the account would be checked and the verification made as to the registered owner, the number of payments credited to the account, and then it would be determined, of course, as to the cash surrender value of that contract at any particular payment which is shown by schedule, and after verification and checking, it would be turned over to what we call the cash disbursements department for the issuance of a check to the registered owner.

Q. From what funds or against what funds would that check be drawn—an example, for instance?

A. Well, for instance, if it was an Annuity Contract, that would be charged to the annuity contract account, and all records are kept separate for the annuity account. That would deal only with the annuity account.

Q. Was not there a time that certain of these series ran short of cash with which to meet these demands for cash surrenders and maturities?

A. Yes, that is true, particularly the income account.

Q. The income account? What happened there?

[fol. 334] A. Well, at that particular time in the maturity demands on the old Special Income Contract—those were claiming a heavy percentage at that time. Of course, that was possibly in 1932 and '33, where the heavy demands for the maturity settlements of income contract and the securities at that time were depressed. They did not have the field—I am assuming this now—they did not want to sell the securities to raise cash to pay those maturity demands, and money from some of these other funds, on which payments were being continued, we were having an income of cash, rather than an out-go, and that was used to pay those income contracts, rather than sacrifice the securities at that particular time to raise the cash.

Q. How were the mechanics handled, and was there a joint bank account for two or three of these funds?

A. What?

Q. A joint checking account or deposit account?

A. On our book, of course, we had them segregated, but there was one general bank account.

Q. That was back in 1932 or '33?

A. Yes, in 1932 or '33.

Q. And what was the result of using cash from the later series of funds to pay off cash surrenders and maturities of [fol. 335] the earlier series?

A. It resulted, of course, in an overdraft on our books in that particular account.

Q. So that every dollar which was used of money of a later series to pay off an earlier series would be reflected on your books originally as an overdraft?

A. That is right.

Q. Did this continue on beyond 1932 and '33?

A. I think it continued beyond 1932 and '33, on up until some time in 1938, at which time these overdrafts were

eliminated on our books by adapting accounts payable and accounts receivable to or from these funds in question.

Q. Then overdrafts were solidified or frozen into accounts payable and accounts receivable between the various funds where the overdrafts had originally occurred?

A. Yes, sir.

Q. And what was the approximate amount of the overdrafts as reflected today on the books of the company between these various funds?

A. You mean as a total, altogether?

Q. Yes, the total one fund would owe another fund, separately by funds.

[fol. 336] A. I would say the income contract account owed the annuity account somewhere around $700,000, or $750,000.

Mr. Lauritzen: What date is that?

Mr. Jaegerman:

Q. If you want to give me an exact date, let us take June 6, 1941. I believe the figures were actually taken off as of that date.

A. Yes, that is right. I cannot give you the exact figures.

Q. Approximately.

A. I would say that the income account owed approximately $1,000,000 to the annuity account, and the income reserve series A account. It is seven hundred and some thousand to the annuity account and two hundred and forty or fifty thousand to the series A account.

Q. Are there any other funds that are owing to funds; that is, are there any other inter-fund loans and advances perhaps affecting the general fund or other contract funds?

A. I cannot say definitely whether it shows in that or not. The general fund owed the contract fund about $62,000, which we call a frozen balance there.

Q. I think this is the first time we have mentioned the general fund. Explain what the general fund is.

A. Well, what we call the general fund is really the stock-[fol. 337] holders' account.

Q. So that the bookkeeping of the company reflects the funds by series, and a general fund, which is a stockholders' fund but not a series fund?

A. That is right; yes, sir.

Q. However, this general fund, or stockholders' fund, is liable for any deficiencies in any of the contract funds; is it not?

A. I would say so; yes, sir.

Q. If you know, how was the general fund created?

A. By the capital structure originally, which has been supplemented by any earnings or income of the investments of that particular account.

Q. And earnings which were allocatable to stockholders, being surplus earnings of certain funds above what was required to improve them?

A. That is right, on the maturity requirement reserve.

Q. All earnings from sales, if there were any, net earnings, might go into the general fund; is that right—net profit on new sales, that is?

A. Yes, the association's portion of income from the sale of contracts.

[fol. 338] Q. And profit on lapsation, or cash surrender, if there were recoveries from reserves, bookkeeping was used to transfer that to the general fund.

A. Yes, that is right.

Q. Mr. McNulty, are you familiar with the practice of Fidelity Investment Association of selling securities from one fund to another fund?

A. Well, I know that—I know of the practice and the policy of the association in that respect, yes.

Q. The inter-fund transfer of securities—that is the way you describe it, is it not?

A. Yes.

Q. During what period did these inter-fund transfers occur?

A. Well, they occurred from time to time at various periods.

Q. As early as when?

A. Oh, I could not recall the first.

Q. 1930 or '31?

A. I would say approximately around that date.

Q. What officer or what employee in Fidelity Investment Association would be most familiar to testify as to the inter-fund transfers of securities?

[fol. 339] A. Well, that would of course be handled as an investment. It would be under the direction of the invest-

ment committee, who in turn would authorize Mr. Young, who had charge of purchases and sales of securities.

Q. That would be Hubert R. Young in New York?

A. That is right.

Q. I believe you testified before that advances to salesmen and to sales representatives were the substantial factor which resulted in the National Sales Agency, Inc., notes of approximately one million dollars.

A. That was substantially true, yes.

Q. Did these advances to sales representatives continue——

A. Pardon me, there, you say advances to salesmen. These advances to the National Sales Agency, that one million dollars, I don't want to be construed as meaning that was advances to the individual salesmen.

Q. No, the Fidelity Investment Association made substantial advances to National Sales Agency, Inc.?

A. That is right.

Q. And these advances aggregated about one million dollars?

A. Yes, sir.

[fol. 340] Q. And the moneys were used by National Sales Agency, Inc., in turn, to make advances to its sales representatives?

A. To handle the sales program for expansion purposes, branch offices, and so on.

Q. And when was the National Sales Agency, Inc., discontinued?

A. 1933—no, it was 1934.

Q. What was the set-up with respect to sales after 1934?

A. Well, it was handled by the agency division, which was created to operate for the National Sales Agency.

The Court: I thought I heard all that yesterday, Mr. Jaegerman. What is the use in going over it again?

Mr. Jaegerman: I wanted to show there were additional advances beyond that time, and very substantial amounts, to sales representatives. This is the background.

The Court: There is no use going into the same evidence we had on yesterday.

Mr. Jaegerman:

Q. Subsequent to 1934 and continuing right through 1940, were not additional substantial advances made to

sales representatives, sales supervisors and employees in the selling department?

[fol. 341] A. That is true, yes.

Mr. Jaegerman: That is all, your Honor.

The Court: Mr. Palmer, do you have any questions to ask the witness?

Mr. Palmer: Yes, your Honor.

The Court: Then proceed with the cross examination.

By Mr Palmer:

Q. Mr. McNulty, the company had certain ways of making profits, did it not?

A. Yes, sir.

Q. Now, using for example a contract of $100 a year. If a person paid in the $100 on that and wanted to quit the company, he only got back $39, did he not, approximately?

A. Well, he would get whatever the cash surrender value would be for that particular contract.

Q. And it amounted to between twenty and forty dollars a year, did it not?

A. That would depend on the type of policy.

Q. Well, on any type of policy it did not amount to over $40 a year, did it?

A. I don't think it did.

Q. Now, if a man took the same $100 and put it into a [fol. 342] baby bond or savings bank, he got back the $100 at the end of a year, did he not?

A. I don't know.

Q. So that the balance between what was paid in and what was paid back out was profit to the company for its sales and keeping it that year; is that right?

A. It was not profit for the company for its sales; it was income for the company to defray expenses of sales.

Q. And the company made a profit on that, did it not?

A. Naturally; at least that was the intention of it.

Q. Now, the company had a large part of their policyholders who took their cash surrender value; isn't that right?

Mr. Reinhardt: Let me interrupt. I want to object to the preceding question unless it is identified as to the time when this company made a profit. It seems to me that the mere fact that it is in this situation that it is in now would

indicate that it did not make a profit, and if it did make a profit, I would like to know when.

The Court: The answer of the witness simply was that it was the intention of the company to make a profit. He did not say the company did make a profit.

Mr. Palmer: They made a profit on the transaction of [fol. 343] which I am speaking, after all expenses and everything else had been settled.

The Court: Overruled.

(Exception.)

Mr. Palmer:

Q. And is it not a fact, and did not Mr. Risley, its president, so admit before the SEC in 1938, the company made from that transaction a profit of three million dollars a year?

A. I don't recall any such testimony. I am not familiar with that.

Q. Are you familiar with the figures that the company, by virtue of its policy holders taking their cash out, made a profit of practically three million dollars a year on that transaction?

A. No, sir, I never heard that figure. I am not familiar at all with that.

Q. It is true, is it not?

A. No, I would say it is not.

Q. Will you deny the testimony of the president of your company, taken before the Securities and Exchange Commission?

Mr. Fleming: The debtor objects.

A. I don't know what evidence he gave.

The Court: I think it is not proper to ask this witness to [fol. 344] deny something you have there.

Mr. Palmer: I think you are right, your Honor.

Q. Now, let's see, your company had another means of profit: if a man quit paying at the end of, say, any period of time, and if then he wanted to take the policy up again after one or more years, you did what you call redated the policy, did you not?

A. That is right.

Q. That redating meant that if originally his policy was to mature at a certain date, you just dated it back the

amount of time he had not paid anything in on it; is that right?

A. Yes.

Q. During that time you had his funds in the company's hands, the reserve part of it, did you not?

A. Yes.

Q. But when it was redated you did not give him any interest on that money that you had kept during the time of the redating period or lapsed period of payments?

A. That is right.

Q. And that was a profit to the company?

A. No, I would say that remained right in the reserve fund; that amount was not transferred to the stockholders [fol. 345] or general fund.

Q. At a certain period of time certain moneys in the reserve fund were divided half between those who matured their contracts and the stockholders of the company; isn't that right?

A. No; the contract provided for a distribution of surplus. On some series of contracts contract holders were entitled to a full amount of surplus apportioned to the contracts.

Q. That was the early contracts?

A. Yes.

Q. What about the rates?

A. The contract holders to participate up to 50% in the amount of any surplus in the fund.

Q. And the other 50% went to the stockholders of the company?

A. That was the intention and the contract so provided.

Q. And that is what happened, they took it in dividends?

A. I cannot answer that; I don't recall when the transfers were made.

Q. But it was transferred to the general fund and from [fol. 346] the general fund you paid dividends?

A. There were transfers; I don't know whether it was all taken out or not.

Q. And from that source alone did not you make $300,000 a year?

A. I don't recall, but I would say no.

Q. Now, then, whenever a person borrowed money, whenever he borrowed back the money he had put into the company, you charged him 6% interest on it, did you not?

A. That is right.

Q. And from that the company made profits, didn't it?

A. No.

Q. It did not?

A. That was classed as an investment of the particular contract fund that the loan was made in. The general fund did not make that loan and did not receive the 6% interest.

Q. Who did receive it?

A. The contract fund itself received that.

Q. The contract fund?

A. Yes.

Q. Now, the contract funds which went to maturity, there were only 5.29% of all those who put their money in, who [fol. 347] ever got it out at maturity; isn't that right?

A. I cannot answer.

Q. Will you deny those figures filed before the SEC in 1938?

A. No.

Q. Then if only one out of twenty reaches maturity to divide the fund, the stockholders got the rest of that fund; did they not?

A. No.

Q. Who did get it?

A. None of those funds matured in its entirety. Any surplus in a fund that the contract holder participated 100% in the surplus, the contract holders would have gotten that.

Q. But only one out of twenty contract holders ever reached that place where they could get that; isn't that right?

A. I am not in position to say.

Q. And the other nineteen took a loss and then the fund was there, and the profit on the nineteen was taken by the stockholders; isn't that right?

A. I don't know; I can't say.

Q. Now, let's see something else. The first contract you [fol. 348] sold was the Special Income; isn't that right?

A. Yes.

Q. And when that came to maturity, as to the 5% who did mature them, you could not pay that out and had to borrow from another fund which you had set up by selling people at a later date; isn't that right?

A. Approximately what I testified to before, yes.

The Court: Are you undertaking to say that this company has not carried on its business properly and that they

have gotten that much in dividends, or something like that?

Mr. Palmer: Yes, sir, I am attempting to show the impossibility of a reorganization of this company in this type of procedure——

The Court: How would that tend to show it?

Mr. Palmer: If they could not carry it on, your Honor, over a twenty-year period and make the company profitable at the end of that time, how in the world can they expect, without new capital structure, to come in this Court and say, reorganize the company and the same group will run it again in the same fashion and make money for the contract holders?

The Court: There has been no intimation that the same group will run it again.

[fol. 349] Mr. T. C. Townsend: Or that it will be run in the same fashion.

The Court: Or that it will be run in the same fashion, no; and so far as the other evidence is concerned, any evidence that the company has taken out large dividends and thereby caused the situation in which it is now, would tend, in my mind, to show a better possibility of reorganization than if they had never been able to get any dividends.

Mr. Palmer: Your Honor, we would like to show that on the first series contracts sold, not more than 5% went to maturity, and they could not even pay those off, and never have without borrowing from another fund; that the second fund came along, and they could not pay it off without borrowing from another fund; in other words, so long as they had a selling plan creating new funds all the time and money profits from selling, the snowball continued; but as soon as the selling stopped, the house of cards fell.

The Court: I can see all that, but I don't see the pertinency of it to the question of whether or not there can be a reorganization, but if you think it is pertinent to that issue, you may go ahead to a reasonable extent.

Mr. Palmer:

Q. Now, a further thing, Mr. McNulty: what class of stock did you have?

[fol. 350] A. Personally?

Q. No, no, the company.

A. Originally they had common stock and now, presently, there is common and preferred both.

Q. And the preferred stock amounted to about 9,110 shares sold; is that right?

A. Yes, sir.

Q. And is it not a fact that in 1930 up to 1932 that stock was issued, the preferred stock?

A. I think so.

Q. And is it not a fact that your company and your company's agent, the National Sales Agency, went to the few persons who did mature their contracts during that period and sold them 5100 shares of this preferred stock out of their matured contracts, so that even those persons who had matured contracts did not get their money back, but got back stock of your company instead?

A. I could verify the exact figures, but I know that policy was pursued at that time.

Q. And it amounted to approximately five and a half million dollars paid to the matured contract holders, and immediately by them used in the purchase of preferred Class A stock; is that right?

[fol. 351] A. How much money?

Q. Five and a half million dollars.

A. The total outstanding preferred stock is only nine hundred thousand; I don't know where that five million dollars comes in, in purchasing nine hundred thousand dollars in stock.

The Court: I think you have an extra cipher on there, Mr. Palmer.

Mr. Palmer: Approximately five and a half million of sales value of contracts was used, which gave a cash surrender of around five hundred thousand, which was used to purchase the stock; is that correct?

A. I cannot verify those figures; I don't know.

Q. They are approximately true, are they not?

A. I don't know.

Q. You were the secretary, who had the issuance of the stock in charge, were you not?

A. I was the assistant secretary at that time.

Q. And don't you know that more than half of that preferred stock was issued to persons who had contracts which they cash surrendered or matured at that time?

A. I know that a substantial amount of the stock was issued by that method, yes.

[fols. 352-354] Q. Would you say that more than 2% who have ever put their money into Fidelity have gotten it out at maturity?

A. I cannot say; can't make a statement as to that.

* * * * * * *

[fol. 355] Q. So far as the Commissioner of Securities is concerned in Missouri, he had no knowledge about this breakdown, as shown on this Exhibit No. 8?

Mr. Jaegerman: I object.

A. I don't know whether he had or not.

The Court: If this witness knew, it would be all right.

The Witness: I didn't know; I didn't have knowledge of that.

Mr. Schurr: Now, I am going to show you what has been marked Exhibit No. 16-A, purporting to be a certification from the Wheeling Dollar Savings & Trust Company of Wheeling, West Virginia, showing the deposits in the different funds that those deposits are to secure, and ask you whether or not that was mailed along with Exhibit No. 16 to the Secretary of State of Missouri.

A. Yes.

Q. Do you see anything on Exhibit 16-A with reference to a breakdown of Special Annuities and Special Annuities M. & R.?

A. No.

Q. Do you see anything on Exhibit 16-A with reference [fols. 356-358] to a breakdown of Income Reserve Series B, and Income Reserve Series B, M. & R.?

A. There is a breakdown here on the Income Reserve Series B.

Q. Just on B?

A. Yes.

Q. In other words, they grouped Series B and Series B, M. & R. together?

A. Yes.

Q. And also on this report by you, you group them together, do you not?

A. Yes.

Q. And on this report, Exhibit No. 16, you group together Special Annuity and Special Annuity, M. & R., do you not?

A. Yes.

Q. And Income Reserve Series A, do you not?

A. Yes.

Q. You never did submit a breakdown as shown in Exhibit No. 8, submitted to the Securities and Exchange Commission, to the State of Missouri, did you?

A. I don't know whether we did, or not. That report, as I recall, I am certain was filed in accordance with the wishes of the State of Missouri.

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[fol. 359-365] Exhibits Nos. 16 and 16-A Filed

Mr. Schurr:

Q. Mr. McNulty, I show you Exhibit No. 16 and Exhibit No. 16-A. Is that the type of report that was sent to the State of Missouri, if you know?

A. That was the regular monthly report form; yes, sir.

Q. And was there any other report sent to the State of Missouri, other than that regular monthly report form?

A. Only on their request.

Q. What type of report would be sent?

A. Well, this was the regular monthly report; unless there was some special information requested by the department, that would be the only report that would be mailed to them.

Q. I see. Now, as to Exhibit No. 8, was there any request from the State of Missouri with reference to a breakdown, as shown on Exhibit No. 8?

A. Not until that particular date; I don't recall any, no.

Q. Was there any on any other date that you know of?

A. Well, I can't recall.

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[fol. 366] Q. Are you familiar with the record of the company in each state in which it operated since you have [fol. 367] been with the company, and as to the fact that in some states the license of the company to do business was revoked or suspended, in other states the license of the company was withdrawn at the request of the company after the states had put some additional conditions on that the company could not meet? Are you familiar with that subject?

A. I am.

Q. What is the situation generally as to the fact that Fidelity either had its license suspended or revoked, or voluntarily withdrawn, in numerous states in which it operated prior to the year 1941?

A. What was the purpose of that?

The Court: What is the situation as to that?

A. Well, we just discontinued the sale of contracts in December, 1940.

Mr. Lauritzen:

Q. I don't think you understand my question.

A. Well, you will have to enlarge on it, then.

Q. Was your license revoked in any state prior to 1941?

A. I cannot say any of them were revoked prior to that time. We withdrew from several states.

Q. Was it suspended in any states prior to 1941?

[fol. 368] A. Yes.

Q. It was? Where?

A. Well, in 1938, or in the early part of 1939, the company was suspended in a good many states.

Q. Can you tell us what they were?

A. I cannot recall definitely the states; I would say most of them.

Q. In most states.

A. Yes.

Q. In Pennsylvania?

A. Pending the litigation of the SEC, and the subsequent court action, yes.

Q. Now, prior to the SEC litigation, had your license been suspended in various states in which you operated?

A. I don't recall any suspension.

Q. Can you tell us in what states the company withdrew prior to the action taken by the SEC?

A. Well, North Dakota, South Dakota, Arkansas, Oklahoma, Florida.

Q. Can you tell us the reason for those withdrawals?

A. Yes, it was due mostly to economic conditions and the sales program was not developed sufficiently to make it worth while to maintain registration in those states.

[fol. 369] Q. With reference to the state of North Carolina, what was the situation there?

A. As I recall it, an application was made to the State of North Carolina, and then it was later withdrawn.

Q. But you did some business there?

A. I think we were qualified there for a period of time, yes.

Q. Mr. McNulty, did you have in the files of the company over which you had active supervision, a complete record of all your correspondence relating to the status of your license in each state in which you have operated during the course of the career of the company?

A. Yes.

Q. Could you get those for us if we had to have them?

A. They could be obtained, yes.

Q. They are up at the Wheeling offices?

A. That is right.

Mr. Lauritzen: We will not ask for them now, your Honor, but it may be they will become pertinent later on.

Q. Mr. McNulty, I am requested to ask you if a copy of the company's annual audit, that was made by the independent public accountants, was mailed to each of the states, from year to year, in which the company did business.

[fol. 370] A. I could not say it was mailed to every state, but I think it was mailed to practically every state. There might have been a few occasions where it was not sent.

Q. You have testified as to who the accountants were, which the company employed, from 1930 to 1940. Did you employ independent accountants prior to 1930?

A. Yes, I think the firm of Ernst & Ernst was employed for several years prior to 1930.

Q. When was the first time the company commenced to employ outside accountants to make audits; or had it always done that?

A. I would say about 1925.

Q. Up to 1925 it made its own audits?

A. Well, at that time, I don't recall, there might have been some few audits before that period; I don't know.

Q. Mr. Reinhardt asked me to ask you what years you were with the company.

A. From August, 1922.

Q. To the close of business?

A. Yes; to date.

Q. Mr. McNulty, do you know whether ever since the inception of the company, and when it began to sell various series of contracts, that in the annual audits, made by out-

[fol. 371] side public accountants, they have made up a balance sheet and an operating statement for each of the separate series of contracts?

A. I don't recall; I would have to refer to the records. In some cases they were made that way, but I could not say definitely.

Q. How long has the company maintained its own books in that fashion?

Mr. Reinhardt: I would like to suggest, in respect to this whole line of questioning, that the witness' answers be confined to a period as to which he has personal knowledge. Mr. Lauritzen brought out that the witness has been with the company since 1922. I assume he has not been a vice president and secretary since 1922, and if in, whatever capacity he was employed in, he had knowledge of these things then I have no objection to his testifying, but if he is testifying to something of which he has no knowledge, I think it ought to be first made clear, or not become part of the record.

The Court: Well, I suppose that will be developed in the witness' answer. Frankly, I don't see the purpose of all this examination as to what happened fifteen years ago in this company.

[fols. 372-373] Mr. Lauritzen: The purpose, your Honor, is that it has been brought out by Mr. Jaegerman's examination, that they maintained these separate accounts, and in fact, in the Haskins & Sells audit, which was introduced, and that there is apparently some theory that each fund stands on its own feet and is a little separate entity all by itself. What I am trying to get at is, how long the company, itself, has been following that theory.

The Court: All right.

Mr. Lauritzen:

Q. Can you tell us that, Mr. McNulty?

A. As far as I can recall, it has always followed that plan.

* * * * * * *

[fols. 374-377] Mr. Lauritzen:

Q. Mr. McNulty, it is a fact, is it not, that on December 31, 1940 Fidelity amended its charter to give it charter powers as a life insurance company under the laws of West Virginia?

A. That is right.

Q. Can you tell us whether, following that action, the company made application in any states other than West Virginia for a license to do business as a life insurance company?

A. No, it did not.

Q. Did they apply in Ohio?

A. No.

Q. Are you positive?

A. I am almost certain on that.

Q. In Tennessee?

A. No.

Q. As far as your knowledge goes, they made no application whatever in any state?

A. Other than West Virginia.

[fol. 378] Mr. Palmer: Reading from the by-laws as furnished me:

"Section 6. The number of directors of the Association shall consist of not more than eighteen stockholders, any seven of whom shall constitute a quorum. The directors shall hold office for the term of one year and until their successors are elected and qualified."

We now ask to introduce in evidence this copy, subject to any correction as to the number which may be necessary, if an amendment is shown in the annual meeting in Feb-
[fol. 379] ruary, 1941.

Mr. Fleming: The debtor objects, unless the entire by-laws are introduced in evidence.

Mr. Palmer: We have no objection to introducing the whole by-laws, but we did not want to encumber the record except with the necessary portion.

Mr. Fleming: It is not encumbering the record at all.

The Court: Well, let the whole by-laws be introduced in evidence.

Mr. Fleming: The debtor now offers to introduce in evidence, and read as an exhibit, the by-laws of Fidelity Investment Association.

The Court: All right, it will be received as an exhibit.

Exhibit No. 17 Filed

Mr. Palmer:

Q. Mr. McNulty, at the meeting in February, was there any approval in writing of any absent directors?

A. Well, I don't recall any. I retired from the meeting.

Q. Up until the time you had retired, had there been presented to you as secretary any approval in writing of the election of a director to fill the remainder of a term?

[fols. 380-388] A. No.

The Court: He testified there were only two other directors.

Mr. Palmer: I think that is correct, your Honor.

Mr. Fleming: I think in the interest of time, we might save this question for argument, unless there is some factual information sought to be brought out, out-side of the by-laws, themselves.

Mr. Palmer: I want to bring out factual matters, and the only reason I am referring to these by-laws is so the Court may understand what is in them.

The Court: Go ahead.

Mr. Palmer:

Q. Mr. McNulty, perhaps this is repetition, but is it not true that while you were there Mr. Fleming was, at his own express request, elected only for the term of that meeting to fill the remainder of the term of the director whom he was succeeding?

A. I don't recall the exact conditions surrounding that, but that was the understanding.

Q. Wasn't that in substance what was expressed by Mr. Fleming, that he would serve only at that one meeting?

A. Yes.

. . . . . .

[fol. 389] Mr. Fleming:

Q. Now, the securities concerning which you have testified that were deposited in the State of West Virginia, under the state law requiring the deposit of securities, where were those securities situate on the 6th day of June, 1941?

A. They were held by the State Treasurer of West Vir-

[fol. 390] ginia.

Q. And where?

A. At Charleston, West Virginia.

Mr. Fleming: The debtor now will offer in evidence the certified copy of the articles of incorporation of Fidelity, to-

gether with all amendments thereto, as debtor's Exhibit No. 20.

Mr. Lauritzen: Can you identify them in some way?

Mr. Fleming: They are certified to by the Secretary of State.

Mr. Lauritzen: Oh, this is a certified copy?

Mr. Fleming: Yes.

The Court: The exhibit will be admitted without any further identification.

Exhibit No. 20 Filed

Mr. Fleming: Your Honor, I now ask that the bill of complaint in the state court proceedings be admitted in evidence, as Exhibit No. 21.

The Court: All right; that will be admitted.

Exhibit No. 21 Filed

* * * * * * *

[fol. 391] Mr. Palmer:

Q. Mr. McNulty, is it not a fact that when these proceedings were instituted in this Court, the newspapers in the City of Wheeling carried front-page head-lines concerning it?

Mr. Fleming: The debtor objects, your Honor.

[fol. 392] The Court: Overruled.

(Exception.)

A. Yes.

Mr. Palmer:

Q. And isn't it a fact that there were front-page editorials in the newspapers in the City of Wheeling, concerning it?

A. There were editorials and front-page articles on it, yes.

Q. Is it not a fact that there were, through the newspapers, organized large meetings, or a large meeting of contract holders?

A. Yes.

Mr. T. C. Townsend: Do you state that as a fact?

Mr. Palmer:

Q. I believe you attended that meeting?
A. No, I didn't.

Mr. T. C. Townsend: Do you state that as a fact, Mr. Palmer?

Mr. Palmer: Yes, I can show you the newspaper clippings.

Mr. T. C. Townsend: You are stating that the newspapers organized these contract holders?

Mr. Fleming: Your Honor, I don't feel that this is at all relevant.

Mr. T. C. Townsend: I just wanted to know that. By [fol. 393] your question you assert that to be a fact. Do you mean that?

Mr. Palmer: I can show you the clippings.

Mr. T. C. Townsend: You assert by your question that the newspapers, by their activities in the circulation of head-lined articles or editorials, were promoting the organization of contract-holders' committees; is that right?

Mr. Palmer: Oh, no, I am not accusing any one of promoting it at all.

Mr. T. C. Townsend: That is what your question implied. I just wanted to know if you meant it.

Mr. Palmer: I did not mean it that way.

Mr. Fleming: This would certainly carry us quite far afield if we are required to meet it, I think. I think the latitude of evidence in this case should be quite broad, but I hardly believe it should be that broad.

Mr. Palmer: In answer to that, you asked Mr. McNulty concerning letters of contract holders and the general tone of those letters. We are attempting to show the same general tone of the contract holders, as demonstrated by the newspapers and by the contract holders, themselves, in the City of Wheeling, the home office.

The Court: Now, Mr. Palmer, I am going to confine that [fol. 394] in this way: if you will show that these demonstrations were directed against any attempt to reorganize this company, then I will permit the evidence to go in; but if it was simply a protest against the particular court in which the proceeding was to be brought, I don't think that has any relevancy here.

Mr. Palmer: I believe, your Honor, I can show that at the meeting which was held of the contract holders—that the purpose of that meeting was to ask for liquidation, and that pursuant to that, Mr. Wood filed, on behalf of some of those contract holders, an answer which asked for liquidation.

The Court: That is proved by the record, is it not?

Mr. Palmer: That is true.

The Court: Then, why bring it into the evidence?

Mr. Palmer: I wanted to have Mr. McNulty testify if he knew of the meeting of the contract holders, pursuant to the notice published in the newspapers.

The Court: Unless you have evidence of other protests than those that joined with Mr. Wood, then I think the record sufficiently shows that without the necessity of any testimony on that.

Mr. Palmer: The record does not show all the people [fol. 395] who attended this meeting. Mr. Wood only picked out, I believe—and so informed the Court—certain representative ones of those groups, rather than put them all in as parties to this proceeding.

The Court: Doesn't his pleading set up the approximate number he represents?

Mr. Palmer: I am not certain.

Mr. T. C. Townsend: Yes, it does.

Mr. Reinhardt: If your Honor please, if any point is to be made of Mr. Wood's attitude about this thing, it should be done while Mr. Wood is here. Unfortunately that is not the case now, as he has left. I do not know why he is not here, but I think the record should show that Mr. Wood is not present at this time.

Mr. Schurr: Well, he had a right to be here. He was here.

Mr. Palmer: Your Honor, he had something to attend to in Wheeling, which made it imperative that he leave.

Mr. Reinhardt: I am not saying this in criticism of anybody, of course, but I think his absence should be noted in the record.

The Court: Mr. Wood had to leave and he explained his absence to me. I am going to adhere to what I have just [fol. 396] said, that if the pleadings filed by Mr. Wood indicate the approximate number of contract holders he represents, then I hold that that sufficiently gets it into

this record, and testimony on that from this witness is not material.

Mr. Palmer: May we check that to see about that, your Honor?

The Court: Certainly.

Mr. Palmer: It names certain persons and says "on behalf of themselves and other persons similarly situated", which, of course, is a general allegation.

The Court: If you can find out from this witness approximately how many people were joining in that petition, I will permit you to do that, in order to simplify the record.

Mr. Palmer:

Q. Do you know of your own knowledge, Mr. McNulty, that there has been a creditors' committee of three leading bankers of Wheeling formed?

A. Yes, I have seen that in the newspaper.

Q. And do you know approximately how many persons signed the petition of that contract-holders' committee?

A. I do not.

Q. May I ask this: were you present at the meeting that [fol. 397] was held, the original meeting?

A. I was not.

Q. Is it not true that when the state court proceedings were instituted, and up until the institution of the proceedings in this suit, there were no such protest meetings, or meetings of any kind of contract holders, to your knowledge?

Mr. Fleming: I object as irrelevant.

Mr. Reinhardt: I ask that the word "protest" be stricken from that question.

Mr. Palmer: That may be done. It should not have been used.

A. Well, I don't know of any meeting.

Q. To your knowledge there were none, and you did not hear of or see anything in the newspapers about any meetings of creditors held, to interest themselves in that state court proceeding; is that correct?

A. That is true.

Q. By creditors I mean, of course, contract holders.

A. Yes.

The Court:

Q. As far as you know about these meetings of the creditors, and the editorials and articles you saw in the papers and so forth, was the objection directed to the reorganiza-
[fol. 398] tion of the company or directed to the court in which the reorganization proceedings were being brought?

A. Well, from the newspaper articles, it just seemed to be a general protest in principal against—it seemed to me to be against Mr. Messick and the set-up.

Mr. T. C. Townsend:

Q. What was that, I can't you?

A. I think from what I saw in the newspaper articles, and so on, the main purpose of the protest was this A. G. Messick set-up. That is the impression I got from the newspapers; I don't think they criticized the Trustee, as far as I know.

The Court:

Q. They just did not want Mr. Messick to have any connection with it; is that it?

A. That was my impression of the newspaper articles.

The Court: Is that all with this witness?

Mr. Palmer: That is all I have, yes, your Honor.

By Mr. Farmer:

Q. The minutes of the meeting of June 3, 1941, recite that pursuant to a notice dated May 27, 1941, a special meeting was held. Did you send out that notice, mail it out?

A. I did not; no, sir.

[fol. 399] Q. You sent no notice of that meeting?

A. No, sir.

Q. Then, do you know, of your own knowledge, that a notice was given to all of the fourteen directors of the company that were named in this meeting—the last meeting when they elected the directors?

Mr. Fleming: To this the debtor objects, for the reason that the evidence shows there were only eight directors serving at the time this meeting was called.

The Court: Sustained as to the fourteen directors.

(Exception.)

Mr. Farmer:

Q. How did it happen that just eight were serving?

The Court: He said the others refused to qualify.

Mr. Palmer: In fairness to the Court. I have copies of those newspaper articles I referred to, and I believe I should produce them for the information of the Court. If the Court deems they are relevant, they can go in; if not, I will not introduce them in evidence. However, I think in fairness I should let the Court see them.

The Court: Well, just have them brought to my desk. It is now after twelve and you can take that up later.

Mr. Palmer: All right, your Honor.

[fols. 400-401] Mr. Palmer: If the Court please, I want to ask the witness to file a copy of the minutes of the special meeting of stockholders held January 24, 1941, which includes the notice of that special meeting. I may say that my purpose in offering that is to show that the company was undertaking to do business as an insurance company; that notice shows all that, and that they were qualified to do business in West Virginia, and were trying to readjust the capital stock for that purpose.

The Court: Are you asking the witness a question?

Mr. Farmer: I am just asking to file those minutes, which I think speak for themselves.

The Court: They are already in, I believe.

Mr. Farmer: Has the whole book been filed?

Mr. Fleming: It is filed under the general order.

The Court: You can refer to any particular part of the minutes contained in the book that you wish to.

Mr. Farmer: This is the part I wish to use, and I would like to file the minutes of the meeting of January 24, 1941, if the Court please.

The Court: All right.

Exhibit No. 22 filed.

* * * * * * *

[fol. 402] FRANK J. MCNULTY thereupon resumed the stand for further recross-examination, and testified as follows:

Mr. Jaegerman:

Q. Mr. McNulty, at the end of 1940 it became apparent, did it not, to the officers and directors of Fidelity Assurance Association that some reorganization was essential?

A. I think that is a fair assumption, yes.

Q. At the end of 1940 it was necessary for Fidelity to register with the Securities and Exchange Commission by filing a notification of registration under the Investment Company Act of 1940?

A. Yes, sir.

Q. And this registration was as a face amount certificate company as described in that law?

A. Yes, sir.

Q. Under that law it would be impossible for Fidelity Investment Association to issue its face amount certificates after January 1, 1941, in the form in which they had previously been offered and sold?

A. That is right.

Q. Furthermore, under the then financial condition of the company it would be impossible to comply with the requirements of the Investment Company Act insofar as the issu-
[fol. 403] ance of a new series of face amount certificates was concerned?

A. I would say that was essentially true.

Q. And that was the concensus of the opinion of the officers and directors of Fidelity?

A. Yes, sir.

Q. Was it not decided at about that time that some step would have to be taken to freeze the status quo until reorganization could be effected?

A. I think that is a fair assumption. They felt some method or plan would have to be devised.

Q. And what were the immediate steps taken?

A. Well, there were several plans considered and developed which were referred to the Securities and Exchange Commission for their advice and approval.

Q. And to what other agency in West Virginia?

A. I don't know, I am not positive as to whether the Insurance Department of West Virginia had seen these particular plans or not.

Q. Well, more particularly the plans were developed with the Securities and Exchange Commission in Washington in mind; however, the office of the Auditor of the State of West Virvinia would be vitally interested in any plan of reorganization that might be effected, would it not?

[fol. 404] A. Oh, absolutely, yes, sir.

Q. And the officers and directors of Fidelity were told that by representatives of the SEC, were they not?

A. Yes.

Q. And joint conferences were arranged with the SEC and the office of the Auditor of the State of West Virginia?

A. I am not familiar with that.

Q. And you attended those conferences in Washington, did you not?

A. Yes, that is right.

Q. Did you say you were not familiar with those joint conferences?

A. No, as to the arrangements. There was a conference in Washington with the SEC and the Auditor and their representatives.

Q. And certain officers and directors of Fidelity Investment Association?

A. That is right.

Q. And along with the proposed reorganization several alternative methods were discussed?

A. That is right.

Q. One was a possible issuance of an insurance policy or insurance contract, and another was face amount investment [fol. 405] certificates or annuity contracts similar to the kind that had been issued by Fidelity Investment Association?

A. They were similar in some respects.

Q. Because the officers and directors of Fidelity felt that their good will or their ownership of certain property rights and their customers were valuable from the history they had developed as an investment company offering an annuity contract?

A. I think that is a correct assumption.

Mr. Lauritzen: I think Mr. Jaegerman is doing most of the testifying. I think there should be some restriction of leading questions.

The Court: The Court is not going to pay any attention to objections to leading questions; overruled. (Exception.)

Mr. Jaegerman:

Q. Is it not true, Mr. McNulty, that the charter of the association was changed so as to give the company the power to issue insurance contracts?

A. That is right.

Q. Is it not true a temporary license was obtained from the Auditor's office of thte State of West Virginia?

A. That is right.

Q. Is it not also true there was a gentlemen's agreement entered with the Auditor of West Virginia that no insur-[fol. 406] ance policies or contracts would be issued?

A. That is right, yes.

Q. Were any insurance contracts or policies issued at any time by Fidelity Investment Association?

A. No, sir.

Q. Did not this temporary license expire at the end of the first four months of 1941; three or four months?

A. April 1, I think it expired.

Q. April 1, 1941?

A. That is right.

Q. Has any license been issued thereafter?

A. No, sir.

Q. What was the business of Fidelity Investment Association from January 1, 1941, to April 11, 1941?

A. Well, it was purely the servicing of the contracts already on our books.

Q. And what kind of contracts were they?

A. They were the income reserve installment savings contracts.

Q. The face amount certificates according to your registration with the SEC?

A. That is right.

Q. And from the period December 9, 1940, to December [fol. 407] 31, 1940, what kind of certificates were issued and sold by Fidelity Investment Association?

A. What is commonly called the face amount certificate.

Q. Which is the same type, the same identical certificate that was issued prior to December 9, 1940 by Fidelity?

A. That is right.

Q. I have been asked to ask you this question: At or about April 1, 1941, was a license issued to Fidelity Investment Association by the Auditor's office of the State of West Virginia authorizing or permitting it to issue insurance contracts for a period of one year?

A. April 1, 1941?

Q. Yes.

A. Not to my knowledge.

Q. Expiring March 31, 1942.

A. Not to my knowledge.

Q. You have no knowledge of any such licenses?

A. No, sir.

Q. You have no knowledge of any renewal of a temporary insurance license?

A. No, sir.

Q. And you were Secretary and Vice President of the company, were you not?

[fol. 408] A. That is right.

Q. As of April 10, 1941, how many active contracts approximately did Fidelity Investment Association have on its books?

A. Well, approximately I would say between twenty-two and twenty-five thousand active.

Q. And what do you mean by active contracts?

A. Well, the ones that were continuing with the regular monthly payments.

Q. And had not been in default for a year, which I think is the default period contained in the contracts, which speak for themselves, being an exhibit?

A. Yes.

Q. Then what action was taken April 11, 1941, either by or against the company?

A. The appointment of the state receivers by the state court.

Q. And was not this appointment the result of the failure of the company to effect a reasonable plan for voluntary reorganization under the appropriate section of the Investment Company Act of 1940?

Mr. Palmer: I object. That suit was brought by the Auditor of the State of West Virginia under his statutory [fol. 409] powers and was not the result of any action on the part of the company, but an act on the part of a state officer.

The Court: Overruled. (Exception.)

A. Well, I would assume that that had a direct bearing on that.

Mr. Palmer: I object to the assumption of the witness.

The Court: Strike out the assumption. If you have any knowledge you may answer.

Mr. Jaegerman:

Q. Don't you have any knowledge on that question, Mr. McNulty?

A. Well, I feel that that was——

Mr. Palmer: Objection on the same ground.

The Court: Yes, that is just answering it in another way to the same effect.

Mr. Jaegerman:

Q. Were not you present at various conferences between representatives of the SEC and the company and the Auditor's office where possible plans for reorganization were discussed in the event of failure of a voluntary plan for reorganization under the appropriate section of the Investment Company Act of 1940?

A. Yes, sir.

Q. And was not one of those plans mentioned an action to be brought by the Auditor of the State of West Virginia? [fol. 410] A. Yes, sir.

Q. And was not the Fidelity Investment Association fully aware that this question was discussed or this action contemplated and would be brought by the Auditor's office of the State of West Virginia.

A. I think so, yes.

Q. If a plan for voluntary reorganization was not consummated under the Investment Company Act, that is?

A. Yes.

Q. And the Fidelity Investment Association saw the actual court papers that had been prepared by the Auditor's office of West Virginia before they were actually filed, did it not?

A. Yes. Well, now, I could not say. I did not see them. I don't know whether the attorneys saw them or not.

Q. Mr. McNulty, how many active contracts are there presently on the books of Fidelity Investment Association?

A. The ones that are actively making payments at this time?

Q. You testified as to the number of active contracts on April 10, 1941. Now will you please give an approximation of the number of contracts which have continued to make payments from April 10 to date?

[fols. 411-412] A. I would say approximately ten or twelve thousand.

Q. Which would be approximately 50% of the total that had been active on April 10, 1941?

A. That would be my idea.

Q. And these continued payments were made in spite of full disclosure of the various court actions that have been

brought against Fidelity Investment Association or by the debtor?

Mr. Gray: We object to the argument in the question.

The Court: Overruled.

(Exception.)

A. Yes, those payments were continued.

. . . . . .

[fol. 413] Mr. Jaegerman:

Q. Mr. McNulty, the inter-fund loans and the overdrafts were all fully reflected on the books of the company, were they not?

A. Yes, sir.

Q. Furthermore, they were set forth in the detailed audit reports of Wilson & Meredith, and Wilson & Cross, were they not?

A. I am sure they were, yes, sir.

Q. And the report of Haskins & Sells?

A. Yes, sir.

Mr. Lauritzen: I don't think the witness knows whether Haskins & Sells or Wilson & Meredith properly performed their work or not. I assume they did but I don't think he can testify to that.

Mr. Jaegerman: This witness is Vice President and Secretary of the company. These audits were furnished him. He is competent to examine them and say whether they reflect these inter-fund loans and overdrafts.

The Court: The objection is overruled.

(Exception.)

Mr. Jaegerman:

Q. Mr. McNulty, were not these detailed year-end audit reports furnished every state official where Fidelity was [fol. 414-418] doing business?

A. I can't answer that for a certainty. I know provision was made in the preparation of a sufficient number of copies to furnish one to each state.

. . . . . .

[fol. 419] Thereupon, JOHN MARSHALL, SR., having been first duly sworn as a witness, testified as follows:

Direct examination.

By Mr. Fleming:

Q. State your name to the Court please.
A. John Marshall, Sr.
Q. Where do you live, Mr. Marshall?
A. Washington, D. C.
Q. What is your profession?
A. Attorney.

[fol. 420] Q. Have you occupied some official position with the Fidelity Investment or the Fidelity Assurance Association?

A. I have been a director of Fidelity Assurance Association for approximately 20 years, and have been chairman of the board for several years.

Q. And you have been a stockholder also?

A. I have been a stockholder even longer than I have been a director, yes.

Q. At the present time what is your official connection or relationship with Fidelity?

A. I am a director and trustee for certain stockholders who deposited their stock, and my firm is general counsel for Fidelity, Marshall & Forrer, with offices in Parkersburg and Washington.

Q. Do you have knowledge of the filing of the receivership proceeding in the Circuit Court of Kanawha County, West Virginia, early in April, 1941?

A. I attended a directors' meeting at which it was developed that such action was probable, and participated in the discussion and action of that meeting.

Q. You might tell the Court, if you will, what the purpose of that proceeding was and what motivated the company, if there was a motive by the company, to have that action [fol. 421] taken.

A. I was not active either in the conversations with the State Auditor's office or the Securities and Exchange Commission, but I understood from those officers and attorneys who were there that no plan of reorganization was deemed practical unless it had the umbrella of a court proceeding, and that the Auditor, having been advised of that deter-

mination, indicated that he proposed then to institute this proceeding.

Q. Now, after that proceeding was instituted, and after receivers were appointed, what participation if any was had by Fidelity in an effort to develop a reorganization in that proceeding?

A. Well, at the meeting at which the directors were advised of this possible proceeding in the state court, all the directors, I might say, feeling that a plan of reorganization could be worked out, in their opinions, undertook to form a committee to formulate a plan, or try to develop a plan, of which Mr. Allan G. Messick was made chairman with authority to select his associates.

Q. How long did that continue?

A. Well, it continued up until the time of the Pittsburgh meeting, I should say.

[fol. 422] Q. Then you may briefly explain, if you will, what the situation was with Fidelity at that time and what led to the filing of this proceeding in this court.

A. Well, I might say that when these by-laws that have been introduced in evidence were adopted, Fidelity, I think had 17 directors. I think in 1938 the number was 17. I believe perhaps in other years it had been even higher. At the last annual meeting of the stockholders an effort was made to fill vacancies and enlarge the board, re-electing practically all of the then directors and I think that perhaps seven additional directors were elected, six or seven. I particularly was interested in that effort, because I was trying to bring back on the board some men who I thought had been valuable to the company, notably, Mr. Koontz, who, while not serving as a director in the interim had been serving as attorney and counsel, and Mr. Grosscup of Philadelphia; and then other names were suggested likewise—a Wheeling man whose father had been a director, a valuable director of Fidelity, whose name I don't just recall now; but by the time of the Pittsburgh meeting none of those men had accepted. As a matter of fact, Mr. Foulk had resigned, so it left only eight directors of the association when we had our Pittsburgh meeting.

[fol. 423] Q. Now, particularly what was the situation in reference to the Fidelity Assurance Association insofar as its business affairs were concerned at that time?

A. Well, we were then under the state receivership, and the only business we had, as has been testified here, was the

keeping in escrow of the accounts of the payments that were coming in; but Fidelity was undertaking no other activity.

Q. If there were any outside state receiverships which had developed in the meantime, tell us about that.

A. Well, it was reported at that meeting that a number of states had—that there had been applications and appointments in some instances made of state receivers; that in some states even two applications were pending; that there had been a meeting of a number of insurance commissioners or state authorities who had jurisdiction over Fidelity in various states and it was the sense of the meeting that it was an intolerable situation; that no reorganization plan could ever be effectively adopted, no matter how fair it was, if we had to go into all these various jurisdictions, and that there ought to be, just as the act contemplates, one jurisdiction where this plan could be submitted, and I might say also that in addition to those directors who were present—[fol. 424] I understood the purpose of the meeting; we had had five days' notice of it—I had invited Mr. Koontz to be present, and not only invited him but urged him to be present. He called me on the telephone, I think the night before the meeting, and said there was some possibility he could not come. I again urged him: told him I thought it was a very critical time for Fidelity and that I thought we needed his advice and counsel. I also invited Mr. Austin V. Wood, who had acted as attorney for Fidelity in the receivership proceedings before Judge Baker, and he wired that another engagement prevented him from attending that meeting.

After hearing of these various situations I thought it was the unanimous action of the board—I notice the minutes say Mr. King refrained from voting but he certainly expressed himself on that occasion and I remember distinctly what he said, and that was that as far as the state receivership operation of the company was concerned, he thought it was very satisfactory and they were doing a good job. I think he so used those very words, but he did not see, with all these proceedings coming out all over the country, how we could ever effect a reorganization plan, which he thought should be done.

Q. Was something said about there being the necessity [fol. 425] of a central authority which could determine the legal questions involved?

A. Precisely.

Q. And that it would be impossible to reorganize without having that situation?

A. That is right. That was developed in the discussion at that time.

Q. Was that primarily the principal reason for the filing of this proceeding?

A. I should say that is a very fair statement.

Q. And the authorization of the proceeding by the board of directors?

A. Yes. I notice the newspaper accounts say, or give the impression anyway, that it was a "packed" meeting. I know I had never discussed the matter with any director before I got there. The directors came in from different parts of the country, into this room, and the discussion was friendly and frank and free, and I heard no other suggestion made by anyone.

Q. There has been something said about the manner in which the resolution was presented or prepared, as to whether or not the resolution was brought in by Mr. Messick or anyone else already prepared and ready for the board to [fol. 426] adopt. What is the fact about that?

A. There was no resolution handed me, I know, and I saw none handed around. As I recall it, you said you had made some notes and if this action was taken you had in mind something about a resolution, and as I recall, in the interim you went out and had that resolution written by the stenographer, dictated it to her; but I am positive no resolutions were passed around and there was no action agreed upon or discussed before this meeting, because the very purpose of having Mr. Koontz, whose firm represented the state receiver, and Mr. Wood, who lived in a northern district, was to discuss every phase of the situation.

Q. To refresh your recollection, I will ask you if the notes I made were not made upon stationery——

Interposing:

A. I think upon the back of an envelope, yes, sir.

Q. —of the William Penn Hotel, possibly on the back of an envelope?

A. Yes, I know they were very rough notes.

Q. That was done there in the room where the meeting was held?

A. Yes.

Q. You have said that you have been rather actively [fol. 427] identified with the affairs of Fidelity for the past twenty years?

A. My father-in-law founded the company. I had a sentimental interest in it before I was elected to the board, which was shortly after his death.

Q. Is your paramount interest in this proceeding for the benefit of the stockholders, or for the benefit of the contract holders?

A. I dislike to proclaim my own unselfishness, but I think I can truthfully say I have a perfectly unselfish interest in this situation. It began with my sentimental interest in my father-in-law. I know what his plans were for this institution. I discussed them with him—he talked to me time after time about that. I have been a stockholder and a contract holder, my wife and I, of course, for years. We were paying on nine contracts at one time and I have matured some since. I have simply had faith in the plan and its purpose. I think it does serve a useful purpose despite the criticism which came after the apparent failure, and my sole interest is in a reorganization of this company and its continued usefulness, and I certainly think that it would be definitely to the interests of the contract holders, because I cannot see anything but severe loss by liquidation. Since I came [fol. 428] in the court room I have been thinking about even our Government has loaned hundreds of millions of dollars to the British Government to prevent liquidation of their securities on this market, and I know of specific instances where sales now, if you can predict any trend in the market, would be very much to our disadvantage, in addition to the terrific cost afterward, to the operation.

Q. As I understand, Mr. Marshall, the principal amount of the assets of Fidelity have been invested in securities, the greater portion of them listed securities?

A. That is right.

Q. And the greater portion of them are liquid, as I understand?

A. That is correct.

Q. Are those subject to market fluctuations?

A. Decidedly.

Q. And when the market goes up, why, the value of your assets increase and when it goes down the value of your assets decrease?

A. Yes, I can give you a specific instance within the last few months, when Fidelity needed some cash it was suggested, I think—within this year certainly, just a few months ago—that we sell 20,000 shares of Hartford Rayon [fol. 429] which the general fund owed. Of course, the reserve funds don't buy the type security but this was a special situation, which was investigated principally by Mr. Koontz incidentally, and the company made an extensive purchase of those securities. At that time when the action was contemplated I think the market price was 9/16ths.

Q. Of a dollar?

A. Of a dollar, yes, and I went to my bank and offered to endorse the note for $10,000 rather than see that stock sacrificed. I noticed that quotation this morning. It is 1 3/16ths, or almost double in value since those few months; and I might say incidentally that I did do it, I endorsed the note and got the company the funds without the sale of the stock.

Q. Do you think it is feasible and practical to work out and develop a plan of reorganization in order that the company may continue in active business?

A. I don't want to qualify as an expert on that. I can only say this, that I am persuaded by my experience that there is a need for a company like this; it serves a useful purpose and it is amazing to me how its contract holders have stood by in all these troubles I have referred to. Not a person criticizes me for advising them to take these con- [fol. 430-432] tracts, although I have advised literally hundreds of people. On the contrary, I have had many contract holders even call on long distance and say they believe in Fidelity and want to stick by it. The impressive thing to me is I have never seen anyone who has ever made a study of this situation in our own organization who has not felt it was feasible. I know that has been Mr. Koontz position all these years. I know that at times people have wanted to step in and get control of the company, but everyone I have ever talked to really feel reorganization is practical.

. . . . . .

[fol. 433] Q. Did there come a time when Fidelity amended its charter and endeavored to write insurance along with annuities or face amount contracts?

A. It was contemplated. They never actually did it but it was contemplated.

Q. How did you happen to amend the charter?

A. Well, there were representations made that—I had personal knowledge of some of these facts—that a great many of our salesmen, in interviewing clients with respect to these contracts, would find they were not interested in that but would be interested in insurance; and, as a matter [fol. 434] of fact, a number of our salesmen were licensed insurance agents, and the two activities, just as many insurance companies have, the two would fit in very well, and also that we had developed ourselves quite an insurance business which was then being—the profits or most of the profits of which were then going to another insurance company, that is, the insurance feature in our contracts.

Q. That is the accrued insurance feature?

A. Yes.

Q. And what company was that handled by?

A. The Lincoln National Life.

Q. The Lincoln National Life Insurance Company of Fort Wayne, Indiana?

A. Yes.

Q. I will ask you whether during the entire history of the company Fidelity have ever at any time issued or sold any insurance contracts or policies.

A. Not that I know of.

Q. I will ask you whether or not it is a fact that the only contracts issued or sold by this company during its entire period of existence are these Special Income, Special Annuity and Series A, B, C, and D contracts which have been admitted in evidence and are marked as Exhibits 1 to [fols. 435-436] 5, inclusive; is that right?

A. As far as I know, that is correct.

Q. What directors were present at the Pittsburgh meeting, Mr. Marshall?

A. All directors were present at the meeting in Pittsburgh except Mr. Burt, who sent word he was attending a telephone meeting in Charleston on that day and could not be present, and Mr. Risley, who was gone on a holiday or was at least away from Wheeling. I understand he wired, though I did not see the wire, that he could be there. The other directors were present.

Q. How many were present, not including myself?

A. Six; two were absent.

* * * * * * *

[fol. 437] Q. Can you further explain your statement that there was need for a company and a business of this character, such as followed by Fidelity?

A. I may be prejudiced in that viewpoint, but I have always felt myself the need. I understood from Mr. Paull why he thought there was a need because of his banking experience; that a great many people open savings accounts but did not continue them. I myself had that experience, [fol. 438] but I matured five Fidelity contracts, and I think that has been the experience of a great many people. I understand Fidelity has disbursed to contract holders approximately $44,000,000. Now, that means those people saved that money. It was never my thought that it is a type of savings or investment that anyone could make huge profits of, but it is a practical savings plan; and of course, it is, I suppose, generally understood that we did not encourage cash surrenders or anything else other than a carrying out of the contract. We sent out literature with our notices and if people became delinquent they were notified and urged to keep up their payments. We tried to present a plan and get people to adopt it to save money, and we have done nothing I know of that is inconsistent with that purpose.

Q. What about the provisions of the contracts which permitted the contract holder who had lapsed over a long period of time, two or three years or longer, to renew and start saving again?

A. There was no forfeiture, no advantage taken of that.

Q. And what about the participation——

A. In the surplus?

Q. Participation in the profits?

[fol. 439] A. Well, that was undertaken. I should say that the reason it was abandoned was that a great many salesmen, we found, were overdoing that and leading people to false hopes that they would make profits by participating in the profits of the company, and in effect a misrepresentation; and that was not the theory or the original idea, and I think it does more harm than good; so that was the reason it was abandoned.

Q. What was the original idea, Mr. Marshall?

A. To provide a plan whereby people might save money by putting in small amounts each month, being advised of the date of their payments; to get people to save money consistently in that way, and then the man who could not

invest only $10 a month would, in the aggregate, that would mean an investment in which he would be part owner, and by making only small monthly payments he would be saving against the future.

Mr. Fleming: You may cross-examine.

Cross-examination.

By Mr. Palmer:

Q. About what year was Fidelity started?

A. 1911, I understand.

Q. It was started as a corporation?

A. Yes, sir.

[fol. 440] Q. And capital of how much was paid in?

A. I think only $50,000.

Q. And for that capital stock was issued?

A. Right.

Q. You became a stockholder when?

A. I think I became a stockholder immediately after the first effort was made to declare Fidelity a bankrupt, which is a great many years ago. The suit was instituted but never process taken and a group was formed to buy out the stockholders who were dissatified at that time. Mr. Paull had died and I bought, I think, ten shares of stock.

Q. Approximately what year was that?

A. I should say around 1920. I am not very good at dates.

Q. For the money you and the other stockholders advanced on the capital stock, you expected to make a return on your investment; isn't that right?

A. Well, with that exception when I became interested I never sought to buy stock in Fidelity. All the stock I owned was stock I had taken off somebody's hands that I had gotten interested, for example, in the company, and I would take the stock off their hands because of that.

Q. You expected a return on your money. You were not [fol. 441] financially able to put up money without——

A. (Interposing:) I am not wanting to adorn myself with wings, but I must tell you the President of this company, who served it I think for $50 a month, did not undertake it as a money-making proposition and neither did I.

Q. At the same time you expected sufficient return on your investment that your money—that any money you invested is entitled to?

A. I think I might controvert that also to some extent. I don't think the stock has ever paid over 4%, and I have known it to sell for $300 a share and I think if I simply wanted to make money that is when I would have sold, or when I saw these dark clouds approaching I would have sold, and I never did sell a share.

Q. You still wanted to make a return on the money you had invested?

A. Naturally, but that was not my primary purpose in becoming interested.

Q. As a matter of fact, the company was formulated and largely owned by Joseph Paull, Sr., your father-in-law?

A. Absolutely that is not true.

Q. What is the correct fact about that?

A. Mr. Paull associated four other directors of the Na-
[fol. 442] tional Bank of West Virginia, Mr. Ogilbie of Wheeling, Mr. Russell Hubbard, Mr. Wood and Mr. W. P. Irvine, and each had equal amounts of stock.

Q. At the time of Mr. Paull's death how many shares of stock did he have?

A. Not over 100.

Q. How many were in his wife's name at that time?

A. None.

Q. And what percentage of the company would that 100 shares of stock, his holding, whatever that was, represent?

A. When it was started he was one-fifth owner. I do not know of any change in that situation. I don't think there had been any other additional stock sold, but I would not be positive.

Q. His holdings never became less than one-fifth interest in the company?

A. I am not sure. Certainly his estate holdings did.

Q. What?

A. Certainly the holdings of the Paull estate became less than one-fifth.

Q. I understood you to say, Mr. Marshall, you were a firm believer in a savings plan whereby persons put in money on the installment plan and receive a return on their
[fol. 443] money, and where in time they are paid their money either in a lump sum of periodically over a period of time?

A. I don't think I went into that detail. I said I am a believer in the savings plan. The best proof is that I have had seven contracts and matured five of them.

Q. And I believe you said you thought this company could be reorganized into a practical savings plan?

A. I have said that was the opinion of all persons I have known who have made a study of this situation, including the senior partner of your firm, Mr. Palmer.

Q. And I further believe you said that practical savings plan would have to be made with no profit to anyone in it?

A. I don't think I said that. I did not intend to say it. I have not any idea of the plan, have not worked on the plan, and don't feel that I am competent to work on it. I have hoped some plan could be worked out. What I meant to testify was that I was not speaking for myself but that everyone I had known and talked to about this for several years felt it could be accomplished.

Q. My question, Mr. Marshall, is this: on your direct examination did not you say you believed a practical savings plan with no profit to be made on it could be worked out?

[fol. 444] The Court: He says that if he said that he did not mean it, which I think is sufficient answer, with the explanation which he has now made.

Mr. Palmer:

Q. It is not your idea a plan could be worked out where there could be profit made by those who would invest in it as stockholders; is that right?

A. I have no recollection of saying anything about that subject.

Q. I am asking you about it now.

A. I have said distinctly I have no plan in mind. I would not even sit here as a witness and say a plan could be promulgated, but I do repeat that everyone I have talked to who has made a study of it thinks it can be accomplished, with proper cooperation and a little unselfishness all around, and no desire to get into the picture just for the sake of fees, and all that sort of thing.

Q. Just speaking for yourself, Mr. Marshall, and I believe you will have to testify for yourself, do you believe a practical plan of savings can be worked out of this present company?

A. A practical plan of savings?

Q. Yes, a practical plan for savers to invest—whether it can be worked out of this company, Fidelity.

[fol. 445] A. I don't understand you. There are other institutions prosecuting a plan almost similar to Fidelity, successfully, if that is what you mean.

Q. No, my question is, do you believe a plan can be worked out of this company.

A. I can only repeat, others who have made a study of it say it can be.

Mr. Palmer: I will have to refuse his answer, your Honor, and ask that he answer my question as to whether he believes it.

Mr. Farmer: I object to the witness undertaking to say what others say.

The Court: Overruled, but the witness is required to answer what he himself believes, if he has any opinion about it.

The Witness: I simply have this opinion, Judge, that I myself, because I don't feel I am qualified to undertake to testify about a plan, cannot say personally, but from my study and conversations with others who, I think, are competent, and who have in turn talked with authorities who have made studies of this and similar situations, believe it can be done, and I fervently hope it will be.

Mr. Palmer: The part of the answer where the witness [fol. 446] says he has talked to others, is objected to and I move that it be stricken out, leaving only the first part as to his own opinion.

The Court: Overruled. (Exception.)

Mr. Fleming: May I ask if from investigation he has made recently, and his experience with the company and with its program and its business covering a long period of years, he believes that a plan can be successfully developed?

The Court: Yes.

The Witness: I think that it can be, and I think if it can be developed so that the company can begin operations again there is just the same necessity and the same opportunity to prosecute it successfully.

Mr. Palmer:

Q. Mr. Marshall, do you think such a company can make a profit to stockholders who invest money into the formation of such company, or persons who would put up the

capital, that they could make a profit on the capital they put up to form such company, in your opinion?

A. That would depend, of course, on the management and many other factors. Of course, the fact that I have not made any might be due to a good many reasons. I personally think the great difficulties Fidelity has encountered has nothing to do with the soundness of the plan, but there were [fols. 447-452] forces and conditions over which they had no control. We have gone through two or three panics and a war in the short history of this company, and I think that has reflected more on it than anything else.

Q. My question is whether or not you think a company can be formed whereby the persons who invest in that company, in the stock of that company, or put up the money for the capital structure of it, can make a profit or return on their money.

A. That will have to be developed—I don't see what value my opinion will have on that anyway.

Mr. Fleming: I think he has answered that, because he said it depended on the management.

The Court: I think he has answered it as fully as he can, Mr. Palmer.

Mr. Palmer: May I have a yes or no answer to the question, if he can answer it yes or no?

The Court: I hold it has been answered as far as the witness can be expected to answer it.

[fol. 453] Mr. Palmer:

Q. Is it your opinion, and was it the opinion of the board of directors, that after the investment company act of 1940 took effect on January 1, 1941, it was impossible for your company to comply with the requirements of that act?

A. I understand it was, unless we could secure additional capital.

Q. So that therefore any reorganization that was contemplated, and which could take effect, was expected to take effect as an insurance company; isn't that right?

Mr. Fleming: The debtor objects.

The Court: Overruled. (Exception.)

A. Oh, no, that was only one of the various efforts—that happened to be the last. We undertook to work out this situation in a number of ways but were never successful in doing it, that is all.

Mr. Palmer:

Q. That is my point, Mr. Marshall, and that the only way it apparently could be successfully worked out was the way which you last attempted, by amending your charter and to work it out as an insurance company.

A. I say, that is one of the things we tried and that did [fol. 454] not work either.

Q. And it was your understanding that that was the way the Auditor was going to attempt to work it out in a state court suit, was it not?

A. I never have had a conversation with the Auditor about that particular matter. I have often talked to him about Fidelity matters. He has been very keenly interested in our company, as it was his duty to be, and he has talked to me about various phases of the company, but never that.

Q. Mr. Marshall, would it not be fair to say your company tried every other way other than an insurance company, and was unable to reorganize?

A. I wouldn't say we tried every other way. We had a committee first, before Mr. Messick was chairman, that I served on too, and your senior partner was the leading figure in that committee, and Mr. Grosscup and other directors, and we undertook to work out various plans and I think some of them were found impractical for one reason or another.

Q. You sincerely and earnestly tried to work out various plans which would be successful, isn't that right?

A. Of course, that mostly involved getting capital and——

Q. And this occurred within the last three or four years?

A. Yes, after our initial difficulty with the Securities and [fol. 455] Exchange Commission.

Q. And your last attempt was as an insurance company?

A. That is right.

Q. That had no change in that you never attempted to sell anything under it; is that right?

A. It just did not work out as it was blueprinted.

Q. After the first of the year the Securities and Exchange Commission would not let you go on any further; is that right, under any plans you had formulated?

A. As I understand, and again I repeat, I did not have the conversations but I understand, from almost the initial difficulty with the SEC they have shown a willingness to sit

down and talk our problems out and these conversations have been going on from time to time ever since. We have never felt that the SEC was showing any antagonism to us but rather a willingness to cooperate. Now again, as I say, I have never had the conversations but that is the attitude reported to me but of course under their responsibility they can make only certain accords; they cannot go beyond their province.

Q. They can only permit you to do what the law which Congress passes allows; is that correct?

A. Yes, sir.

Q. And they advised your company that under its then [fols. 456-457] set-up it would not be allowed to go on and do what it had been doing?

A. Well, I am again only repeating information which you are in position to give more accurately even than I, because you see the gentlemen more frequently than I do, but I understand that it was the position of the Commission that no sort of reorganization plan could be effected unless it had the protection of a court.

. . . . . .

[fol. 458] Q. Can you answer this question as to what rights of the contract holders needed to be modified so that the earnings received on securities and assets owned by the debtor will be sufficient in amount to meet the requirements under its outstanding contracts?

Mr. Fleming: I object.

The Court: This witness has already answered that in his other answer, it seems to me. He says he doesn't know anything about that.

Mr. Palmer: If that other answer covers it I will be glad to accept it, your Honor.

A. I only know of them; I don't want to claim complete ignorance. As I understand it, our difficulty is in deficiency in some of these funds, and not the fact that we could not operate a business successfully on our present contracts. As I recall, within the last few years we have taken profits largely out of stock sales transactions and put into these accounts to the amount of about one and a half million dollars. If we had sufficient time to continue that operation with the same success, and were permitted by the authorities, we might do it, but the difficulty about a situation

like that is that these contracts are maturing and have to be paid now or next month. Whether some plan can be [fols. 459-460] worked out, again I say, I am not qualified to say.

. . . . . .

[fol. 461] By Mr. Lauritzen:

Q. How long had yourself and the other officers of the company known a situation existed which would call for some readjustment or reorganization of the company? How long have you recognized the existence of such a situation?

A. I should say it only became apparent after our dif- [fols. 462-464] ficulties began in the various court proceedings.

Q. Do you refer to the SEC proceedings that took place in——

A. I don't mean that the SEC proceeding was the controlling factor, but that was closely followed by the receivership proceeding which caused a cessation all over the country for months, and these various things have also entailed very heavy expenses. I think, without any reflection on anybody, that that was the first time that it became apparent there was something else had to be done.

. . . . . .

[fol. 465] Q. From the period 1930 on, during which time I believe it has been testified that overdrafts existed in the various funds, did not the company pay dividends to its officers or to its stockholders, and did not you as a stockholder receive dividends?

A. The company has a very unenviable common stock dividend record, what years they paid and what years they did not, I know they never paid dividends unless counsel [fol. 466-467] and the officers said they were authorized to pay it out of earned profits.

Q. Did they pay dividends during the three years in which you were chairman of the board?

A. I can't remember.

Q. Can you check that, or who can give us that information?

A. I should think Mr. McNulty, but I had nothing to do with the recommendation of dividends, if that is what you want to know.

Q. Nothing to do with the recommendation?

A. No.

Q. Would not the board of directors declare the dividends?

A. Always, on recommendation of the president or other officers.

Q. But the authorizing action was on the part of the board?

A. The board had to approve it, yes.

Q. And to your knowledge there were dividends paid during the period in which overdrafts in the various funds existed; is that correct?

A. I think so.

. . . . . .

[fol. 468] By Mr. Farmer:

Q. Mr. Marshall, if the averments in debtor's petition showing that there is a deficit of approximately $2,600,000 in these reserves on these outstanding contracts is a true and correct statement of the debtor's condition, would you not say, in order for the company to be reorganized it would be necessary to cover that deficit in some way in the plan of reorganization?

A. Well, certainly something has to be done about it.

Q. Now, do you know or have you any idea of any way in which that could be done?

Mr. Fleming: I object. That is the same question that has been gone into.

The Court: Mr. Farmer, it seems to me that does not [fol. 469] have anything to do with the feasibility of a plan, because in the event of liquidation the deficit certainly could not be covered. In the event of reorganization probably the deficit could not be covered either; but the deficit is there and your question is would not it be necessary to do something to cover that deficit. I do not think that has anything to do with the feasibility of the plan.

Mr. Farber: It has this Your Honor: the witness, who has a high official position with the company and has had over many years, and who is presumed to have some knowledge about the company's affairs, has taken the stand for the debtor in aid of this proceeding. It seems to me he ought to be able to shed some light on this question that

the Court is confronted with. The witness admits the deficit would have to be covered in order for the company to reorganize and operate successfully. In other words, a reorganized company——

The Court: No, he did not say that. He said something would have to be done about it.

Mr. Farmer: Unless there is some way we can cover that deficit then how can we have a plan of reorganization, and how could it be said there is a reasonable prospect of reorganization?

[fol. 470] The Court: I don't think anybody is going to create two and a half million dollars out of nothing.

Mr. Reinhardt: Along those lines, your Honor, I would like to reiterate something I said early in this hearing, the applicability of which perhaps was not as apparent then as it becomes now, and that is one of the things provided for by Chapter 10 is a report by the Trustee as to the conduct of the debtor's affairs, and as to what facilities exist and what materials exist for a reorganization. Now, before any such report is submitted nobody is in a position to form any opinion as to whether a particular kind of reorganization plan can be worked out or not. The most that can be determined at this preliminary stage of the proceedings is whether there is a reasonable prospect that something along those lines can be done, and I think that is the full extent to which the law requires your Honor to go in connection with the issues raised on the question of jurisdiction, and if your Honor finds there is such a reasonable prospect on the basis of the information made available here, then that aspect of the jurisdictional question will be decided in that way, and otherwise to the contrary, but all this testimony and arguments as to a particular kind of plan, or the particular assets or materials which [fol. 471] are available for a plan of reorganization just "jumps the gun" on the procedure contemplated by the act, if the Court please.

Mr. Farmer: The courts have held it is the duty of a district judge, when a petition is filed by a debtor such as in this case, to first determine he has jurisdiction; and the debtor carries the burden of proving that there is a reasonable prospect of reorganization. The courts have held repeatedly that that reasonable prospect must be

something more than just a forlorn hope, as the Circuit Court of Appeals from this circuit has said in a recent case; something more than just an emotion, dream, phantasy or hope of those who have been connected with the company and who would like to see it go on. We know it is not to be expected that they would come here with a blueprint of the plan, filling out all of the details and the number of joints, cross-sections and everything of that kind; but at least the Court is entitled to an outline of it. We ought to know whether it is going to be a circle or a square or a rectangle or a rhomboid or something else; but they cannot even tell us whether it is going to be an insurance company, face amount certificate company or what. They tell us nothing. It is just a phantasy, and I think we have a right [fol. 472] to cross-examine on these material points, such as covering a great big gap in reserves on these contracts.

The Court: As a matter of fact, you are talking about a plan which Mr. Marshall or the company may have in mind; but the plan that will be presented to this Court, if one is presented, will be from the Trustee, and how is Mr. Marshall going to know anything about any plan the Trustee may be able to formulate later? I am going to restrict your examination to other phases than the kind of plan Mr. Marshall may have in mind. I am going to rule that any questions relative to that are out of order.

Mr. Farmer: Your Honor, I was not asking about the kind of plan but about the essentials any plan must have.

The Court: I think that is equivalent to the same thing. (Exception.)

Mr. Palmer: If the Court please, it is required that the debtor prove good faith, and one of the essentials of proving good faith is that they prove that a plan of reorganization can be effected. I thoroughly agree with the Court that the plan which is ultimately presented will come from the Trustee, but in order to substantiate the ground of good faith, which is controverted in practically all these bills, the debtor must show that it is reasonable to expect that [fol. 473] a plan can be effected.

The Court: Yes, but in showing that, if all the facts which are shown are such that the Court can determine that there is some reasonable basis for expectation of a plan

being evolved, it is the Court's opinion that it is not necessary that the debtor have such a plan outlined in its own mind.

Mr. Palmer: I think your Honor is correct in that, of course.

The Court: Therefore, I am just going to consider all of these facts that have been presented to me, and determine from the facts and not from some opinion Mr. Marshall may have, or Mr. McNulty may have, but determine from the facts whether it is reasonable to believe a plan of reorganization can be formed.

Mr. Palmer: I had in mind that the only way a plan of reorganization can be effected in the ultimate conclusion is for 66⅔% of every class of creditors to approve of it, and if a deficit of two or two and a half million dollars exists by virtue of which they will be cut down, then this Court should consider that fact as a bearing on whether the contract holders will approve any plan.

The Court: The Court will consider that fact, but the [fol. 474] Court will not consider what Mr. Marshall may think about it.

Mr. Palmer: I think that is right, other than he has expressed an opinion on which he should be cross-examined to a small extent as to his own personal opinion, I believe, your Honor.

Mr. Fleming: He certainly has been cross-examined, I submit.

The Court: His opinion may have some bearing on his good faith.

The Witness: We would not have taken the action in Pittsburgh, Mr. Palmer, if we had not hoped—and it was not a "forlorn hope," as Mr. Farmer expressed it—and if we had not had some basis for the idea that it could be done. How it is going to be done, I cannot say; I simply don't know.

Mr. Farmer: If the Court please, the parties to the litigation who join issue on the averments that there can be a plan, and when the petitioner comes in court and asks the Court to take jurisdiction, are entitled to show those vital, material facts which will militate against any feas-

ible plan being proposed and confirmed, and on this side of the table we conceive, and especially I representing some [fol. 475] contract holders, conceive that this deficit of $2,600,000 admitted in the petition is about the most vital and material fact that militates against the prospect of any plan.

The Court: All right, but they are not attempting to prove by this witness there is such deficit. That is admitted. That becomes a matter of argument later. Why ask this witness?

Mr. Farmer:

Q. Mr. Marshall, you said you had talked with some other people, and I believe you said with some authorities, did you not, about the prospect of a reorganization?

Mr. Fleming: The debtor objects.

The Court: Overruled. (Exception.)

A. I have talked to people who have had experience in reorganization. I think probably you misunderstood me. I said that I had talked to people who had told me they had talked to authorities.

Mr. Farmer: I object to that, your Honor, when he says that he has talked to people who told him they had talked to authorities.

The Witness: I mean our own people.

Mr. Farmer:

Q. You have not talked with any of the insurance commissioners or securities commissioners in these different [fol. 476] states where the company has been doing business and where it must go back and do business if it is reorganized, about whether there can be any plan of reorganization put into effect, have you?

Mr. Fleming: The debtor objects.

The Court: Overruled. (Exception.)

A. I have explained that, Mr. Farmer—that I have not. I have assumed though they would have just the same interest I have in it. That would be the interest of the contract holders, and that they would prefer reorganization rather than liquidation.

Mr. Farmer:

Q. You would assume also, would you not, that they would try in every way to uphold their duty to the contract holders in those states where the company has sold these contracts on the faith and strength of the deposits and securities being held in those states to guarantee the performance by the company of its obligations in those states, and you would assume that a reorganization of the company that initiated those contracts and obligations in those states could not hope to launch off on a successful career selling people on a savings plan again?

Mr. Fleming: The debtor objects to that question.

The Court: Sustained. (Exception.)

[fol. 477] Mr. Farmer:

Q. Now, Mr. Marshall, you said this company, since December 31, has not engaged in any business except just to receive such moneys as came in?

A. That is my understanding.

Q. Now, during this last seven or eight months you have turned the possibility of reorganization over in your mind every day, have you not?

Mr. Fleming: The debtor objects.

The Court: It seems to me you are going along the same line that Mr. Palmer pursued. I am not going to permit that. If you have anything separate and apart from what Mr. Palmer brought out, I will be glad to permit it.

Mr. Farmer:

Q. Well, you have said you concluded it would take an umbrella of some court proceedings over it——

A. I did not say I did.

Q. Well, that somebody else said it would take an umbrella——

Mr. Fleming: The debtor objects.

Mr. Farmer:

Q. All right, let me ask you what you meant by "umbrella"?

The Court: Overruled.

(Exception.)

A. Well, that a plan of reorganization would have to be effective with all the commissioners, that to under- [fol. 478] take to reach an accord with all the commissioners, to go from one state to another and undertake that was an impractical thing, and that the only effective way would be to do as we are doing in this proceeding, so that a plan can be worked out and there is just one tribunal we have to deal with, although all the other parties have rights and their rights are protected in this court.

Mr. Farmer:

Q. Isn't this the situation in a nutshell, Mr. Marshall, that this company is faced with the situation where it has been doing business in a great number of states and in those states it has deposited some of its assets to attempt to comply with the laws of those states?

A. Yes, sir.

Q. And under those laws those assets must be held for the protection of the policy holders in those states; isn't that right? And those officials——

Mr. Fleming: The debtor objects to that question as calling for a legal conclusion.

The Court: Let us see if it does.

Mr. Fleming: That is the question your Honor will be called upon to decide in the future.

The Court: He has not finished the question yet. You may proceed, Mr. Farmer.

[fol. 479] Q. And those officials in those states who hold those deposits are attempting and intend and will endeavor to perform their duty to the citizens of those states by holding those deposits, and unless some power can be found to take those assets back and take them away from those states and cut down the rights of the citizens of those states to those deposited securities, then the company has no chance of reorganization?

The Court: The question is improper and the objection is sustained.

(Exception.)

Mr. Farmer: On what ground, if the Court please?

The Court: Just because it is sustained. The Court does not have to announce the ground.

Mr. Farmer: That is all I care to ask.

Mr. Palmer:

Q. Mr. Marshall, at your Pittsburgh meeting is it not true that the concensus of the meeting was that under the state proceedings each state was proceeding separately and that the board of directors, or the gentlemen there purporting to be the board of directors, believed that by bringing a suit in a United States District Court all of the assets of the various states could be collected and administered in one suit?

A. I don't remember that being stated precisely that [fol. 480] way. My recollection is just what I think I testified to before; that we felt that a reorganization could not be effected if we had to go around all these separate tribunals, and I might say that your senior partner concurred in that belief, and in conversation with Mr. Fleming and me he so expressed himself, but said he did not think this was the time, that all the ground work ought to be done in the state receivership first, but finally that method would have to be undertaken.

Q. And was not the reason of the filing of the suit here by this board of directors so that all of the assets in all of the various states could be collected in the hands of one trustee?

A. I never heard that suggested. It did not register with me, if it was stated. I think the resolution accurately depicts what was decided upon.

Mr. Reinhardt: Your Honor, I have just a few questions.

The Court: You may proceed.

By Mr. Reinhardt:

Q. There has been a lot of talk here about umbrellas in this testimony. I wondered whether the modification of the charter which took place in the latter part of 1940 could be regarded as a kind of umbrella, Mr. Marshall?

[fol. 481] A. The expression was not originated by me. It came afterwards and it was reported to me to have originated in your building.

Q. I think you are crediting us with something we are not entitled to, but it is a hallowed expression and, I think, a very apt one.

A. It is possible someone else might have said that, but that is really where it was reported to me that expression came from, that it would take the umbrella of the court.

Q. Is it fair to say that the modification of the charter was a sort of an expedient adopted by the company in view of the fact that the investment company act was about to become effective and the company knew it could not readily comply with the requirements of that act?

A. I should say, Mr. Reinhardt, all during this period we were tryng to evolve something that would be satisfactory to the Securities and Exchange Commission and to Mr. Sims, and on several occasions we thought we had parties interested who came and talked to officials as to whether or not the plan would be feasible, and this was just another one, as I looked at it.

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[fol. 482] Edgar B. Sims, having been first duly sworn as a witness, testified as follows:

Direct examination.

By Mr. Fleming:

Q. What is your name, please?

A. Edgar B. Sims.

Q. Where do you live, Mr. Sims?

A. Charleston, West Virginia.

Q. What is your official position?

A. Auditor of the State of West Virginia and Ex Officio Insurance Commissioner.

Q. How long have you held that position?

A. Since March 4, 1933.

Q. Mr. Sims, as part of your duties, did there come a time when you supervised securities which were deposited with the proper authorities of the State of West Virginia by the Fidelity Investment Association or the Fidelity Assurance Association?

A. That is part of my duties under the law of this state, yes.

Q. How long have you had that relationship or have you been performing that service or duty for the assets deposited by Fidelity?

[fol. 483] A. I have been attending to it for over eight years.

. . . . . .

[fol. 484] Q. Now, in determining the amount of securities to be deposited by Fidelity, what type of value did you use?

A. Well, early in 1934, I believe, I promulgated a method of evaluating securities somewhat similar to that used by the Comptroller of the Currency for national banks, and somewhat, but not so closely, related to the Insurance Commissioner's method of evaluating securities.

Q. I was wondering if you would tell the Court what amount in value of the securities of Fidelity were deposited with the Treasurer of the State of West Virginia here in Charleston on the 6th day of June, 1941.

Mr. Lauritzen: Will you ask him what kind of value, whether market value, or what?

Mr. Fleming: Yes.

The Court: I did not get clear that the witness had answered the other question, Mr. Fleming. You asked him which one of these, the par, the sound or the market value was used, and I don't believe he answered that, did he?

Mr. Fleming: I will withdraw the question.

Q. Now, Mr. Sims, will you answer that question the Court had reference to?

A. I have applied the sound-value method in this state.

[fol. 485] The Court: Well, find out what that is.

Mr. Fleming:

Q. Now, how do you arrive at that, Mr. Sims?

A. In 1934 I prepared that method, which I cannot quote exactly. There are copies of it in my office and in the regular proceedings in former litigation in Wheeling, concerning the company; but, broadly speaking, all those bonds that were paying their interest, not in default in principal, were rated at par, regardless of what the company had paid for them. For instance if they paid 110, that would put them at 100; if they paid 80, we put them at 100.

The Court:

Q. What bearing did you give to the current market price?

A. Your Honor, on bonds which were in default in principal or in interest, they would be put down at absolute

market, which is a harsher method than that used by national bank or state bank examiners in that regard.

Q. Suppose a bond was not in default, but was selling at 50 on the market. Would you still count it at 100?

A. For the purpose of determining whether it was a going concern, I had to do that. We started that in 1934, when there was no basis of valuation.

[fols. 486-489] Mr. Fleming:

Q. Did you do that in figuring the assets of Fidelity deposited with the State?

A. I did. I will say further, the company paid thirty-two for $300,000 worth of certain bonds. I allowed them to go in at par. They are worth 90 now, and never have defaulted. The market price is what somebody thinks they are worth, but the interest paid tells the story.

The Court:

Q. That is upon the theory of giving credit to a going business, meeting its obligations?

A. Yes, sir. If the Court will permit me: it is strange that my method of valuation worked out rather well with the Insurance Commissioner's method and the method employed by the national bank examiners. On one occasion we thought we would test them out, and on a large concern like this it panned out rather closely, not over 3% variation of total worth.

[fol. 490] Q. As I understand, Mr. Sims, your primary obligation is to look after the securities and evaluate the securities that are deposited under the laws of the State of West Virginia; is not that right?

A. That is correct.

[fol. 491] Q. In carrying out the law, you certainly must have these figures somewhere, have you not?

A. Oh, they are taken, an over-all picture, twice a year; but I don't care so much for one state. What I am after is the over-all picture. That is what I pay attention to particularly, ever since I have been there.

Q. You are primarily interested in West Virginia, and not primarily interested in Wisconsin or Tennessee; isn't that right?

A. The law makes it my duty to look after all of them.

Q. Because you supervise directly the activities of Fidel-

ity by reason of its being incorporated under the laws of the State of West Virginia; is that right?

A. Yes, sir; but there is a big excess in the State treasury under the liabilities existing in the State of West Virginia. I do not know how much, but I know it is large.

Q. But the Treasurer of the State of West Virginia has in his custody a large amount of securities that are allocated for the benefit of contract holders living in other states; isn't that right?

A. Yes, sir.

Q. What I would like to know, Mr. Sims, is what amount [fols. 492-497] of securities, appraised either at their sound value or market value, were on deposit with the State of West Virginia, on or about June 6, 1941.

A. There was approximately $13,000,000; I am not sure whether that is market value or sound value.

Q. Approximately $13,000,000?

A. Yes, sir.

* * * * * * *

[fol. 498] Mr. Lauritzen: I would be glad to, your Honor.

Exhibit No. 24 is an exhibit by Mr. Sims, the Auditor of this state, and, briefly, it certifies that on December 31, 1940, the company amended its charter, and a copy of the amendment is inserted. It shows that Mr. Sims, as Insurance Commissioner, approved that amendment; that subsequently that amendment was approved by the Secretary of State, as amending the corporate charter of the company, and it shows that on the same date, December 31, 1940, the corporation made application, a copy of which is [fol. 499] attached, to the Insurance Commissioner of the State of West Virginia for license to engage in the life insurance business as provided in Article 3 of Chapter 33 of the 1931 code of West Virginia as amended, and such license was granted, a copy of which license is also attached.

Then, it shows further that on January 13, 1941, the company made application on forms supplied by the Insurance Commissioner for that purpose for the licensing of twenty-one persons to engage in the sale of life insurance policies, which said licenses were issued.

It shows further that on January 14, 1941, the company filed in duplicate and secured approval for use in this state of a form, entitled "Special Annuity Contract".

It also shows that on January 27, 1941, the company filed, in duplicate, and secured approval for the use in this state, of the following forms: Ordinary Life, Ten Payment Life, Fifteen Payment Life, Twenty Payment Life, Fifteen Year Endowment, Twenty Year Endowment, and Ten, Fifteen and Twenty Year term.

It further shows that the licenses issued to the company as an insurance company, as of December 31, 1940, expired on March 31, 1941, and that a renewal of that license was issued dated April 1, 1941, for a term of one year, expiring [fol. 500] March 31, 1942.

The Witness: Your Honor, may I explain?

The Court: Yes.

The Witness: Those licenses were actually issued, but the company was told not to sell anything until they got right with our office. I did that for the purpose of—licensed them for the purpose of receiving installment payments on the outstanding contracts.

Mr. Jaegerman:

Q. The face amount certificates they had issued up previous to that date?

A. Yes.

The Court:

Q. You say you told them not to use it until they "got right" with your office. Did they ever get in shape so they were permitted to use it?

A. No, sir.

(Recess from 3:40 p. m. until 4 p. m.)

The Court: All right, Mr. Palmer, are you ready to proceed with your cross-examination?

Mr. Palmer: Yes, your Honor.

Q. Mr. Sims, you were first elected auditor of the State of West Virginia when, or you first took office when?

A. March 4, 1933.

Q. And you have been continuously since that time?

[fol. 501] A. Yes, sir.

Q. Auditor of the State of West Virginia.

A. Yes.

Q. And under the laws of the State of West Virginia as Auditor, you are also Ex Officio Insurance Commissioner?

A. Yes, sir.

Q. And under your supervision is the securities department of West Virginia?

A. Yes, sir.

Q. Did you have any knowledge, other than general, of Fidelity Investment Association, prior to your taking office?

A. No, sir.

Q. And your connection with them and your knowledge of them has been through your official capacity since you took office; is that correct?

A. That is all.

Q. Now, you are governed by the statutes of the State of West Virginia, and were governed during your relations with Fidelity Investment Association; is that correct?

A. Yes, sir, as far as the circumstances would permit.

Q. You were and are required, under those statutes, to [fol. 502] exercise a discretion which is invested in you; is that correct?

A. In evaluating securities that is the case.

Q. And in your supervision of Fidelity, and other companies of this type, you have certain discretionary powers which you exercise?

A. Yes; but sometimes it does not avail anything.

Q. What?

A. Sometimes it did not avail anything.

Q. The statutes of West Virginia require that certain deposits be made with the State Treasurer, by reason of companies such as Fidelity Investment Association doing business; is that correct?

A. Yes, sir.

Q. And did you require those deposits to be made?

A. As much as I could obtain.

Q. As much as you could obtain?

A. Yes.

Q. Now, in connection with that, did you have from time to time conferences with the officers and directors of Fidelity Investment Association?

A. Yes, sir.

Q. Did you, not at length but briefly, go into that from [fol. 503] the time you took office, as to what, through your official capacity, you advised them to do and wanted them to do in connection with making deposits, and in running

their business in accordance with the laws of the State of West Virginia, as you saw it?

A. Well, I was wholly unacquainted with this business when I came into office. You know, I had been a school teacher and a peddler and there were some things I had to learn. However, I soon found out that their liabilities far exceeded the market values of their holdings, and I discovered a lot of advances by Fidelity to the National Sales Agency, Inc., of $957,000. I questioned the propriety of that and the validity of the note. Various and sundry persons connected with the company assured me it was perfectly good, that it was a perfectly good note; that it was out on anticipated commissions that were earned and would come into the treasury of the company.

Q. How much was the amount of that note?

The Court: He said $957,000.

Mr. Palmer:

Q. Proceed, Mr. Sims, if you will.

A. And I kept watching them and checking from time to time on the values of securities. At that time I had Mr. Bradford, who later went with the Securities and Exchange [fol. 504] Commission, in the office. I could not get them to reduce that note, as I had ordered them to do. I ordered them to reduce the note out of earnings of the sales agency, and to limit their expenses in the operation of the company to the loading in the contracts sold.

In other words, I demanded that they operate the company upon the loadings for commissions to the salesmen and bookkeeping, and at the same time show a profit to reduce this huge note.

They told me they were obeying me.

Q. Did they obey you?

A. No, sir.

Q. And instead, when you further investigated, what did you find out?

A. I found at the end of the year that they had increased that note by $90,000.

Q. And what action did you take then, Mr. Sims?

A. Immediately I called the directors together. They met in Washington and I appeared before them.

Q. Tell us what occurred there, please.

A. Well, I took my coat off.

Q. And what went on then?

A. I told them at the time to get somebody in charge of [fol. 505] the company who knew what stealing was when they saw it, and was opposed to it. The president of the company said he had been obeying me, and right there we disagreed. I told them he had not; that he had disobeyed me, and his board of directors, because they had been ordered to take $10,000 a month out of Fred King's commissions, and apply it on he note, and to pay the interest.

Q. Who was that man?

A. Senator Sutherland.

Q. About approximately when did this conference occur?

A. Some time in 1934.

Q. Go ahead and tell us what you did further, if anything.

A. Well, I ordered them to decapitate Fred King.

Q. Was that done?

A. They did not do it. Well, I got in my car and rode to Wheeling, and walked in the president's office, and wrote in pencil on a slip of paper to go over and take charge of the sales agency's bank account, and put it in the company's till, or I would close them down at the end of business that day.

Q. Did they do that?

A. They did.

[fol. 506] Q. What other suggestions did you make, or orders did you give?

A. In the meeting in Washington, I laid down this formula which has been introduced in evidence here, in substance; I delivered that in my speech to them there, with the additional advice that they buy bonds every month with their collections. They were taking in from three hundred thousand dollars to half a million dollars per month, and I insisted they buy bonds that never defaulted in the depression in interest or principal, and they could be bought at a huge discount at that time, and to keep on buying and buying and buying as long as they had any money to buy them with, and had any bonds in sight to be bought at a discount.

Q. Did they follow that advice?

A. Mr. Young in New York has done that nobly, I must say.

Q. Has the wisdom of that suggestion or order been indicated to you at times?

A. Yes, sir; the company was in the red in market values in 1933 about $7,000,000, and in market value today it is in the red only two and a quarter million dollars.

Q. Has that decrease of being in the red been by virtue of the following out of the policy you laid down for them [fol. 507] in buying bonds at discount and holding them?

A. It has, in spite of the reckless squandering and spending money by the officers in Wheeling.

Q. Now, with reference to that, you say you ordered them to cut down their expenses and salaries and so forth. Did they do that?

A. They told me they did. They said they were living within their means and operating at a profit; but I found out last February, when I examined the books down here in the bank building on the river bank, the office building, it is now, that they had advanced $480,000 to the sales force.

Q. Were they using a prohibitive amount of money to sell their contracts?

A. They were spending money in excess of the commissions loaded in the contracts and collected.

Q. And was that amount a larger amount, in your opinion, than should have been spent for selling these contracts?

A. It certainly was. It was taking money that belonged to the stockholders and contract holders and giving it out to a lot of "gimme" gang salesmen.

Q. Now, from time to time during that period, did you [fol. 508] order them to cut down their expenses?

A. I did.

Q. Did they obey you?

A. They would obey it for a time at the home office, and then the first thing I would know they would skyrocket the salaries again. I ordered them to cease renting expensive offices for the sales managers all over the country, and they assured me they would do it as fast as their contracts or leases expired, and they could do it.

Q. Did they do it?

A. No, they were still paying $9,000 a year in Chicago for expensive offices, and I closed them; and they were making advances to their hirelings—I think, for instance, Mr. Pulfer had an $8,000 advance at the date of closure; A. L. King of Wheeling, a $3300 advance, with no security.

Q. What can you say as to whether or not the company told you they were making profits and paid dividends to

stockholders when, as a matter of fact, they were not making profits?

A. Of course, I am not an expert accountant; but, in my opinion, they have not earned a dollar in ten years. If they paid an income tax, they paid it erroneously, in my [fol. 509] opinion.

Q. Did they, during the last ten years, pay these dividends out to the stockholders?

A. I think they did for two or three years, over my protest and advice. There is one year I cannot say much about, in the year 1937, when the prices of bonds were sky high, and they were in the black by about $800,000 in market values.

Q. Mr. Sims, do I understand you correctly that by virtue of their type of investments that the economic period, or the economic phase, of the United States may at one time, on market value, have made their securities inadequate to meet thier liabilities, and a short time or months or years later, due to economic changes, the same securities may be more than adequate to meet their liabilities?

A. Yes, they were able to meet their liabilities in 1937, according to the statisticians.

Q. And that is on market value?

A. Yes; but that was occasioned by the great intake of money and the purchase of bonds and the rapid rise in market value of bonds.

The Court: Does that simply mean, in any company like this if they start up on a rising market, they can remain [fol. 510] solvent, but if they start up on a high market, after that closes down, they will become insolvent? Is that what it means?

A. Yes, sir, your Honor. That is the reason the insurance commissioners and bank examiners all over the country do not take the market value at any particular period, but rather take the average and devise some method of charging the securities so as not to give unduly high values to them as such at any particular time, or unduly low values at any other time.

Mr. Palmer:

Q. So that is why you evolved your plan of what you call sound value?

A. Yes, sir.

Q. It was not a plan which would be based on the liquidation of a company at any one given date, but rather the sound value of the company over a given period of time?

A. Yes, sir. Of course, that is, you understand, assuming that they will not eat up their future in riotous living in any particular year or period of years.

Q. What can you say as to this company being able to compete with the sale of government defense bonds and other bonds by the United States Government, which yield the investor practically 2.9%, as compared with this com-
[fol. 511] pany, which averaged a yield to the investor of only 2.56%; that is, whether it can compete with the government bonds backed by the United States Government?

A. Of course, that is problematical. It may be that government bonds will pay a higher rate of interest in the future; or it may be they will pay a lower rate, but a company like this cannot pay 4 or 4½% on its contracts, now, because it cannot invest its money in first-line bonds and earn that.

Q. And the only way it has been able to exist over the last few years, to your own knowledge——

A. Is because they bought bonds on a low market.

Q. Yes, is because they bought bonds on a low market, on your advice, and those bonds have now risen, due to higher market.

A. Yes, sir.

Q. And that is the only reason they have been able to exist during this period of time; is that correct?

A. That is the only reason they are improved in their financial statements.

Q. And is it not a fact that contracts of this type can only be sold to the general public by means of what is called "high pressure salesmanship"?

[fol. 512] A. Yes.

Q. That is salesmanship which is expensive to the company who tries to put it on?

A. That is the way they have been sold, at too great an expense.

Q. And were they able to sell them any other way, Mr. Sims?

A. I don't know; they never tried it.

Q. Mr. Sims, as Ex Officio Insurance Commissioner, whenever you felt a company of this kind had its obliga-

tions impaired, you are permitted to file a suit in the Circuit Court of Kanawha County to collect the assets and administer them; is that correct in substance?

A. Yes, sir.

Q. And did you at any time determine that such a suit should be brought by you to collect the assets and administer them?

A. Yes, sir.

Q. And that was the suit of April 11th; is that right?

A. Yes, sir.

Q. Mr. Sims, in that suit you did not, however, turn over to the state court receivers the deposits made to the State of West Virginia?

[fols. 513-517] A. No, sir.

Q. You did keep those under your own control?

A. Well, that is debatable as to who has control of them.

Q. In any case, they were not turned over to Mr. Ross B. Thomas and H. Isaiah Smith, the state court receivers?

A. No.

Q. To your knowledge, Mr. Sims, was this note of the National Sales Agency ever paid off?

A. The records show that by gradual payments the note was reduced to around seven hundred or seven hundred and fifty thousand dollars.

Q. And is there any security at all to back that up to make it worthwhile?

A. Nothing except the paper it is written on. We struck it out in casting up the assets of the company.

* * * * * * *

[fol. 518] Mr. Palmer:

Q. Pardon me, but did you investigate the connection of Mr. Messick with the debtor company?

A. I had been informed that Mr. Messick and another man had agreed to put up half a million dollars to form a side corporation and take over this company by degrees, and it went on for a long time and I began to make inquiries through Mr. Young in New York—I visit his office every time I go there to sign road bonds—and through Mr. Arthur Koontz I learned that Mr. Messick was chairman of the board at $1,000 a month. I learned immediately that the president, Mr. Risley, the attorney and perhaps another individual from Wheeling were coming to my office, and I

prepared a letter and ordered them to decapitate Mr. Messick as chairman of the board at $1,000 a month.

The Court: Who was that attorney?

A. Mr. Tom Foulk.

Mr. Palmer:

Q. You, in your official capacity, knew that there was a plan being formulated whereby Mr. Messick and an asso-
[fol. 519] ciate would invest half a million dollars of new capital and take over this company, and put this amount of money in as new capital?

A. I am not sure it was a real plan. There may have been a pretended plan, a device to get inside; I don't know.

Q. Can you recall approximately when this idea of Mr. Messick's was attempted to be worked out, about putting forth the half million dollars, that is?

A. A year and a half ago, something like that; maybe two years.

Q. After you ordered them to cut off Mr. Messick's salary of $1,000 a month, was that done?

A. That is what the officers of the company tell me.

Q. Did Mr. Messick have at any time other than a one share nominal interest in the company?

A. Not to my knowledge.

Q. Is that the same Mr. Allan G. Messick who was on the 7th day of June, 1941, employed by the Trustee, together with Mr. James Fleming, who was employed by the Trustee "for the purpose of assisting your Trustee in marshalling the assets of said debtor, which are now institute in divers states outside the territorial limitations of the State of West Virginia, and also for the purpose of assist-
[fol. 520] your Trustee in the development and formulation of a plan of reorganization for the affairs of debtor in this proceeding".

The Court: You are mistaken in your premise to the question. Mr. Messick was never employed by the Trustee.

Mr. Fleming: And neither was I.

Mr. Palmer: Your Honor, I think a petition was filed in this Court, asking for authority to employ them for that purpose.

The Court: Yes, but that was not your question. You asked him if he was one of the persons employed by the Trustee, and he has never been employed.

Mr. Palmer: I beg your pardon, perhaps I did not read it correctly.

Mr. Fleming: I might say further that, at my personal request, the Court vacated that order.

The Court: The Trustee filed a petition requesting authority to employ Mr. Messick and Mr. Fleming, but they were never employed and the Trustee later filed a subsequent petition asking that that order be vacated, which it has been, as to both Mr. Messick and Mr. Fleming, and they never had any connection with the Trustee.

Mr. Palmer: What I wanted to do, your Honor, is to get from this witness the connection the Mr. Messick of whom [fol. 521] he is speaking and the Mr. Messick about whom the Trustee was speaking—if they are one and the same person, that is.

The Court: All right.

A. It is the same man. The same man is here.

Mr. Fleming: Is this supposed to be a personal attack on me? If so, I want to know it.

Mr. Palmer: No, sir; I am merely citing to the Court certain parts of this record, and I am also citing the facts that occurred at the meeting in Pittsburgh. It is in the answer filed by Mr. Sims.

Mr. Fleming: And prepared by you.

Mr. Palmer: Prepared by the Attorney General.

Mr. Fleming: If Mr. Messick has done anything illegal, I think that fact should be disclosed; if he has done anything of that nature as chairman of the board of directors of the company.

The Court: That is what I am looking for.

Mr. Fleming: And if I have done anything dishonorable as attorney for the debtor, let that fact be disclosed. I don't think it is either fair or honorable to make veiled attacks on counsel or any one else in this case, if the Court please.

Mr. Palmer: Mr. Fleming, I think you are entirely cor-[fol. 522] rect and I am only citing from the answer of the Auditor in which it charges that under Section 157 you do not have a right to appear in this proceeding.

Mr. Fleming: I have a right to appear in this proceeding as attorney for the debtor.

Mr. Farmer: Your Honor, it seems to me that this is competent on this ground, that we are entitled to show the

entire relationship that those parties who brought this proceeding here in this Court have had with this company. Mr. Messick's relations extend back over this period of years, trying to do something with it, and also we think we are entitled to show their relationships with the Trustee.

The Court: In so far as the question relates to matters of good faith in filing the petition, I am going to let you question Mr. Sims about Mr. Messick, but as to the last question in regard to certain things you say appear in the record, I am not going to permit that because neither Mr. Messick nor Mr. Fleming have ever had any connection with the Trustee.

Mr. Palmer: Your Honor, we want to show this: that Mr. Messick and Mr. Fleming were two of those who were present at the meeting in Pittsburgh, at which time the resolution authorizing this petition to be filed was presented; that [fol. 523] the records disclose that that petition was filed June 6th, and that the following day the Trustee filed a petition asking to employ these two persons for the purposes set out in that petition; that an order was entered and that then the Court had a preliminary hearing and that matter was dismissed when objection was specifically raised by Mr. Wood on behalf of the contract holders to the employment of Mr. Messick in any——

Mr. T. C. Townsend: That was not the reason for it at all.

Mr. Palmer: We want to show the entire line of conduct from the meeting in Pittsburgh until the Court, himself, and the Trustee asked that he not have any further connection with it.

Mr. Fleming: That fact is not disputed, that we had the meeting, of course, and all the evidence goes to show that, and we had a right to be there, just the same as Mr. Sims has a right to come here, and it seems to me that an effort is being made to impute motives to people that probably have motives just as honorable as Mr. Palmer or Mr. Sims or any one else.

The Court: At any rate, there is no expectation that you can get from this witness that any of those things you [fol. 524] have just stated are not true, and nobody is denying them, so why ask him about it?

Mr. Palmer: My question, your Honor, which started this discussion, was to ask Mr. Sims if the Mr. Fleming he knew and meant was the same one who carried on these later

proceedings, and that is admitted now, so I will not go further into that.

The Court: All right.

Mr. Palmer:

Q. It is set out in your answer and shown by a table, that there would be approximately 117 classes of creditors, being derived from the fact that there are fifteen states where deposits are required and twenty states in which the debtor was required to obtain a license, and then there were seven or more of the various series of contracts. Mr. Sims, do you have any knowledge personally as to whether a plan of reorganization can be worked out that will be approved by 66⅔% of the 117 classes of contract holders?

A. I do not.

Q. In the event of liquidation of this company, is your department of the State of West Virginia prepared and permitted by law, and adequately equipped to do whatever steps are necessary to administer and liquidate the affairs [fol. 525] of the company in West Virginia?

The Court: In West Virginia, or in all other states?

Mr. Palmer: In West Virginia only, your Honor, of course.

The Court: All right, then. He may answer that question.

A. No, sir; we do not have the room nor the employees, and I would not do it if I had the room or the employees at the State's expense.

Mr. Palmer:

Q. Now, Mr. Sims, there has been considerable testimony here concerning whether or not a reorganization can be had of this company into any sort of company whereby it would sell face amount certificates and whether it could or not. Have you formed any opinion from your experience with this company, and other companies, as to whether or not in the present economic times a face amount certificate company could be reorganized which could comply with the Investment Company Act of 1940, and which could successfully operate?

A. You mean reorganize with the corpse of this one?

Q. Yes.

A. No, sir.

Q. You base that on your experience that you have had [fol. 526] as State Auditor and your knowledge of this company and its affairs?

The Court:

Q. Mr. Sims, you asked the question whether he meant to reorganize out of the corpse of this one. What do you mean by that?

A. With the same outfit, the same aroma and halo around the things which has been there: no company on earth can be successfully managed by such a crowd as they had up there, or any of their hirelings.

The Court: That is what I thought the witness meant and, for that reason, I suggest to Mr. Palmer that the answer is not of any particular benefit to the Court.

Mr. Palmer: Your Honor is undoubtedly right.

Q. Mr. Sims, would it be possible for any one to successfully operate a face amount certificate company which could in these economic times operate successfully?

A. I doubt it very sincerely.

Q. Let me ask you one other thing: has the fact that this particular company has first been in state receivership and now in bankruptcy proceedings in this Court had anything to do with the fact that it would be difficult to reorganize this particular company as a new company?

A. That would be a factor to consider; a very grave one. [fol. 527] Q. And would it be a favorable or adverse factor, do you think?

A. A very grave one.

The Court: You say in your opinion you have very sincere doubts whether any face amount certificate company could operate successfully. I want to ask you with reference to this particular company, which has already gotten into an insolvent position, whether in your opinion a reorganization on some basis, forgetting about the "crowd", as you called them, that have been in control before, other than immediate liquidation, will have a fair chance of producing more for the contract holders than immediate liquidation would.

A. I had thought so. I had thought it could be reorganized into an insurance company by the consent of the contract holders:

Mr. Palmer:

Q. Mr. Sims, that was your idea in the state court proceedings, was it not?

A. Yes, sir; that was one of them, and the other was to get rid of that gang that had been wrecking it.

Q. Mr. Sims, under the statutes whereby you are required, in the case of insolvent insurance companies, to [fol. 528] administer their assets and, if necessary, to bring suits in Kanawha County for the purpose of aiding you, you had done that in this case, and were prepared to go through with it, were you not?

A. I was going to attempt it. I don't know whether I could have gone through with it or not.

Q. You have brought such suit, seeking the aid of the Circuit Court of Kanawha County; is that correct?

A. Yes, sir.

Q. You were prepared to attempt to carry out the law to the best of your ability; was that right?

A. I always try to.

Q. And if it had been necessary to employ further employees and get additional space to carry that out, you would have complied with the law and have done so; is that right?

A. I would have done it at the expense of the company.

Q. And so far as you are concerned, you would have complied with the requirement of the statutes to administer and liquidate if need be?

A. Yes, sir.

. . . . . .

[fol. 529] By Mr. Townsend:

Q. About the first thing you did, as I understand it, after you were elected Auditor, with reference to this company, was to investigate the National Sales Agency; is that right?

A. That was one of the things.

Q. That was one of the first things you did; isn't it?

A. We did it some time; I don't know how soon it was, Mr. Townsend.

Q. Well, it was not very long after you assumed office; isn't that right?

A. Possibly within a few months; yes.

Q. And, of course, in your first investigation you discovered enough irregularities, as you thought, to condemn the sales agency?

[fol. 530] A. Worse than that.

Q. What do you mean by "worse than that"?

A. I could use a shorter and uglier word than that, Mr. Townsend.

Q. I don't yet know what you mean.

A. Well, it might be improper for me to use that word in the presence of the Court.

Q. At least, you thought it should be ended?

A. Yes, sir.

Q. And you felt rather vigorously about it; didn't you?

A. I did.

Q. And that was soon after you went into office?

A. Yes; but they fooled me by assuring me that the money would be repaid immediately.

Q. How long did it take you to get rid of that?

A. It took me about a year; and then I had to take a club with nails in it and hit them over the head.

Q. Well, I think you did a good thing when you did get rid of them.

A. I just delayed too long.

Q. Then you looked into the salaries and expenses of the company?

A. Yes, sir.

[fol. 531] Q. What did you find?

A. It seemed they were spending a lot of money.

Q. Well, in what respect were they spending a lot of money?

A. Oh, they had a far-flung sales program, reaching all over the country.

Q. We have eliminated the sales organization, now. What other expenses outside of that did they have that were excessive?

A. Oh, a lot of high-priced officials.

Q. Who were they?

A. Well, Mr. Sutherland was president.

Q. What did they pay him?

A. About $15,000 a year.

Q. Any other high-salaried officers?

A. A. L. King, Fred King, Evans and Reed.

Q. Were they all connected with the company or with the sales agency?

A. Well, they put them on the company payroll, most of them.

Q. After you eliminated the sales agency, the company employed them, you mean?

A. As I recall, most of them went on the company pay-[fols. 532-533] roll, yes.

Q. Was Fred King ever on the company payroll?

A. No, I told them to get rid of him. I would not stand for that.

Q. You have not yet told me of but one salary that was paid, and that was $15,000 a year. Did they have any attorneys' fees in there?

A. Yes, sir; but I cannot tell you without the record, from memory, about that, because that was eight years ago.

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[fol. 534] Q. The company probably would be sound to-[fol. 535] day; isn't that right?

A. Except for one thing, Mr. Townsend.

Q. What is that?

A. They promised too much in their contracts, and the economic change in interest rates, money rates, wouldn't stand that.

Q. Well, if it had been sound in every other respect except that, would it not have been possible, Mr. Sims, to have so modified the contracts, or at least the future contracts, so as to place this company in a sound condition to continue under your spendid management?

A. That is what would have to be done. You would have to modify the contracts.

Q. Well, it could have been done; I mean, the contracts could have been modified, the future contracts, and brought in line with existing economic conditions?

A. You would have to modify all contracts.

Q. No, I am talking about not all of them, but the future contracts.

A. No, it is doomed to distress with the present promises in their old contracts sold back in 1920 to 1932, that they would receive $1200 in installments, over a period of ten

years, and taking out the loading for commissions and book-
[fol. 536] keeping, leaving around $1100 in cash, and at the end of ten years they would begin paying back $200 a year for ten years,—well, it is something that cannot be done; simply a mathematical proposition that won't work.

Q. Mr. Sims, let me see if I understand you. The structure of the company economically and financially was unsound from the beginning; is that right?

A. Yes; they promised too much in the twenties.

Q. And never could have succeeded?

A. Not at that rate they were promising.

Q. No matter about the extravagance or anything else; if run economically it was bound to be condemned; is that right?

A. I think so. I think they were quarreling with Ray's arithmatic all the time back there; and there was another reason it was doomed to failure. They had bought German government bonds, Mexican bonds and second mortgage bonds and fourth mortgage bonds, and of course, they are not worth much.

Q. That gets back to the management?

A. Yes.

Q. That doesn't have anything to do with the structure, [fol. 537] the financial structure of the company. Now, I have a statement here showing about $53,000 paid out in 1939 for legal expenses. Do you know anything about that?

A. They paid too much out to auditors and for legal expenses.

Q. I did not ask you about auditing; I asked you about legal expenses.

A. Yes, sir; that expense was too much. They spent an enormous sum for legal expenses.

Q. Did you make any complaint about that?

A. I did.

Q. Did you have them dismiss the attorneys because of your complaint?

A. That was the thing I could not control, the lawyers' fees.

Q. They paid them out of money under your control; did they not?

A. I wish I could have had control of it.

Q. Well, you fired King, and you fired Messick; why didn't you fire the lawyers?

A. If I had had authority to, I expect I would have.

Q. The only reason you did not do it was because you did not have the authority?

[fol. 538] A. If I had had the authority, they would have been fired and the salaries divided in about four.

Q. I say, the only reason you did not fire them was because you did not have the authority?

A. Yes, sir.

Q. Did not you have the same authority over the expenses of the company, so far as paying lawyers was concerned, as you had with reference to paying any other officials?

A. I am wondering if I did not exceed my authority then.

Q. You mean in firing the officers?

A. Yes.

Q. Well, it would not hurt you and would make no difference if you exceeded it once more, would it?

A. I did it and got away with it, and I am glad I did it. If I had it to do over again, I would do it sooner.

Q. In 1938, '39, '40 and '41, the books of the company show $92,000 paid to one firm of lawyers. Did you scan those accounts?

A. I never saw them; don't know what firm it is.

Q. You stated, in reply to a question asked you by Mr. Palmer, that no new annuity company or insurance company [fol. 539] or face amount installment certificate company could operate in West Virginia without a license from you, did you not?

A. I think that is the law.

Q. I am not disputing it.

A. Of course I am not a lawyer.

Q. Well, you said that?

A. Yes.

Q. And you said also that you would not license any company that might be built upon the corpse of this company to write installment contracts in West Virginia; did you not?

A. That is what I said.

Q. Suppose the company was reorganized out of new cloth entirely. Do you feel that you would——

A. (Interposing.) I just doubt——

Q. Just a minute, now. Supposing it was reorganized out of new cloth entirely, a reorganization that was authorized after this matter had gone through the Federal Court, under Chapter 10, do you still say you would not grant it a license to operate in West Virginia?

Mr. Palmer: If your Honor please, Mr. Townsend, by his question is assuming the very question that we are try-[fol. 540] ing throughout this entire procedure, whether or not there can be a reorganization here, a reorganization out of whole cloth, and whether or not it can get permission to operate under the Investment Company Act of 1940; so that his question assumes—and upon any assumed basis of facts there must be substantial evidence to base the assumption or hypothetical question, and he assumes a fact which is the entire purpose of this hearing. I do not believe there has been any such proof made upon which a hypothetical question of that kind can properly be based.

The Court: The objection is overruled. (Exception.)

A. I don't understand what you mean when you put that verb in the past tense, or the past perfect tense—"was reorganized".

Mr. T. C. Townsend:

Q. Well, I will say "will be reorganized".

A. Organized by whom; and how much money will be put in it? I want to know that before I could answer that. I am not going to permit it to be organized on thin air.

Mr. Palmer: I object.

Mr. T. C. Townsend:

Q. You can answer it or not, Mr. Sims.

Mr. Palmer: I would like a little more explanation as [fol. 541] to what "reorganized out of whole cloth" means.

The Court: He said "new cloth".

Mr. Palmer: All right, I would like some explanation as to what that means before the witness answers.

The Court: That is clear enough. I don't think that requires any explanation.

A. I think it inadvisable to relicense the company to sell these contracts exclusively. Twenty-six of the biggest insurance companies in the last five years have lost $66,000,000 on annuity contracts.

Mr. T. C. Townsend:

Q. I understood you to say, Mr. Sims, that no matter if this Court would authorize a reorganization of the af-

fairs of this company, and vest in it authority to sell face amount installment certificates, you would not relicense it?

A. No, sir; but I might permit them to sell some face amount of contracts under certain conditions, if their principal business was insurance.

Q. And you think you have that authority?

A. I don't know; I would try it. They might make me license them, I don't know, but I would find out. That is the way you lawyers learn things.

Q. Well, Mr. Sims, you filed a petition in the Circuit [fol. 542] Court of Kanawha County, did you not?

A. Yes, sir.

Q. You filed that under the statute which gave you the right to do it?

A. Yes.

Q. In that petition, you asked for dissolution or reorganization, did you not?

A. Yes, sir.

Q. You proposed, when you filed that bill of complaint, to reorganize the affairs of this association through the Circuit Court of Kanawha County?

A. That was what I had hoped to do.

Q. Then you do think it can be reorganized?

A. Not as an annuity company alone.

Q. Part annuity?

A. I have serious doubts about the annuity business in any form.

The Court:

Q. How did you intend to reorganize it through the Circuit Court, Mr. Sims?

A. I don't know; I am not a lawyer, Judge. I had hoped to work out a plan and submit it by mail to the contract holders.

Q. What sort of plan had you hoped to work out?

[fol. 543]. A. Well, that was very thin and nebulous.

Q. Suppose you give it to us, however thin and nebulous it may be.

A. I thought the company could be mutualized and turned over to the contract holders, give the stock to the contract holders; it ought to belong to them because there is nothing left there for the stockholders.

Q. Do you think there would be any more trouble about doing that in the Federal Court proceeding than in the Circuit Court?

A. I don't know; I am not a lawyer.

Mr. Palmer: Your Honor, it has been called to my attention the fact that the West Virginia Legislature, in 1941, repealed the Annuity Company Law, being Article 9 of the insurance laws, Chapter 31 of the code, and that, therefore, the hypothetical question Mr. Townsend is asking would be impossible of performance.

(Off-the-record discussion.)

The Court: If you find that to be the case, that can be brought in in the briefs.

Mr. T. C. Townsend:

Q. When did you decide to institute this suit in the Circuit Court of Kanawha County, Mr. Sims?

[fol. 544] A. Well, do you want the whole truth, Mr. Townsend?

Q. That is what you are sworn to tell. You would not tell anything else, would you?

A. All right. In conference with representatives of the company, I told them I wanted to go over the records.

Q. Who were the representatives of the company?

A. Mr. Arthur B. Koontz.

Q. Anybody else?

A. He was in my office. I told him I wanted to go over the records.

Q. Anybody else?

A. No, sir.

Q. All right, then, go ahead.

A. I wanted to check the company. I had ordered them in November or December, on the 20th of the month, to trustee all their stock in the hands of disinterested parties, not politicians or anybody that owned any of the stock, or related to anybody who owned stock. They could run that thing at a profit. Well, they fooled along several months and did nothing, and never even honored me sufficiently to answer my letter, and I demanded the books be brought to Charleston for examination, and told them to pay for one of the examiners and I would pay for the other. I took a man [fol. 545] out of my office and retained the services of David.

Jayne here in Charleston, and they went to work on the assets of the company, and I discovered they had what I called "stolen" $480,000 out of that company, and handed it out to that "gimme" gang all over the U. S. A., and I got mad and cussed a little, which I have not done more than two or three times in my lifetime.

The Court: Do you mean you have not gotten mad more than two or three times in your lifetime, Mr. Sims?

A. I have been mad, but never cursed; and I made up my mind that something was going to happen, and it has happened.

Mr. T. C. Townsend:

Q. Well, what did you advise Mr. Koontz to do?

A. I told him I was going to bring suit.

Q. Did you talk to any other officials of the company, any one other than him?

A. No sir; I told him to call them up. He was the only one who seemed to have any ethics or honor here in this matter.

Q. And you told him what?

A. Well, I told him I was going to bring suit. Now, Tom Foulk was always honorable, of course, but he was sick. [fol. 546] Q. You told him you did not want anybody to have anything to do with the prosecution of the suit that had anything to do with the company?

A. That is what I told him.

Q. Is that what you told him?

A. Yes, sir; I told him I was going to get out that gang up there, that they were a bunch of robbers.

Q. Why wasn't he one of them?

A. He had been fighting with me all these years.

Q. But he did belong to the company, didn't he?

A. Did Mr. Young belong to the company? They were in the minority, and couldn't get them to do anything, of course.

Q. Then, there was a fight in the company, and you were with the minority, and the others would not let the minority do what it wanted to do; is that right?

A. I was against the robbers, and they were for them. That is the gist of it; if you want it in old fashioned English.

Q. Who filed your suit down here for you?

A. Oh, I went to the Attorney General's office, Mr. Partlow.

The Court: Mention has been made of some attorney [fol. 547] who got $92,000 from this company. I want to know who that attorney was.

Q. Can you tell me that, Mr. Sims?

A. I don't know, Judge.

Mr. T. C. Townsend: Mr. Sims can probably get it from the record, your Honor.

The Court:

Q. Will you find that out?

A. Mr. Marshall is here; I don't know whether it is in the records or not. I would like to say one thing, if the Court will permit, however. One of the directors who met in Pittsburgh has been living in property belonging to that company and has owed a large amount of rent for it, and there were some rubber checks in the till of the company. I don't know whether they were paid or not, from that same party.

Q. Who is that?

A. Jack Marshall.

Q. How much did he owe?

A. I don't want to state for fear I might make a mistake about it.

Q. Approximately? Was it a large amount?

A. It runs in my mind it was $1400 rent, maybe $2400, I don't know; and there were eight or ten bad checks in the [fol. 548] till of the company.

Mr. T. C. Townsend: Your Honor, that information about the attorney was handed me as coming from the books of the company. I think there will be a witness here as to that.

The Witness: My impression is, it was an aggregate of sums paid various attorneys in many states. I don't know. That was never revealed to me; but that is another thing that needed attention, if that is true, Mr. Townsend.

Mr. T. C. Townsend: I am not defending it. I am just calling your attention to it. Now, in the year 1938 there was paid $7,043.72; in 1939, $53,634.61; in 1940, $28,022.82; in 1941, $2,940.68, making a total of $92,041.83.

Mr. Fleming: Your Honor, I think Mr. McNulty would probably know of that, or some of the other employees from Wheeling.

Mr. T. C. Townsend: Well, I have no objection to handing this paper to the Court, if your Honor would care to see it (handing paper to the Court).

The Court: All right; we will recess now until seven o'clock.

Thereupon, at 5:15 o'clock p. m., a recess was taken until 7 o'clock p. m.

[fol. 549] Evening Session

The hearing was resumed at 7 o'clock p. m. after recess last noted.

Present—the same parties as heretofore noted.

Mr. Farmer: If the Court please, before adjourning Mr. Townsend was asking about some attorneys' fees, and I did not see the materiality of it, but he had a sheet of paper, which I believe he handed to your Honor. I wonder if I could see that sheet of paper.

The Court: Yes, sir, unless it is confidential to Mr. Townsend.

Mr. Townsend: Your Honor, I said there might be a witness on the stand later who would develop it. Until it is developed, I don't think it should be gone into.

The Court: Well, I am going to ask a question, and get an answer to it before we get through, so that may serve your purpose.

Mr. Farmer: I just wanted to see what the Court was seeing, was all.

The Court: If Mr. Townsend wants to show it to you, it is all right with me.

Mr. T. C. Townsend: I am not offering it in evidence [fol. 550] yet. You will get the result of it before the case is over.

Mr. Farmer: I am making the request that I be allowed to see it.

The Court: You are not going to be allowed to see it unless counsel wants to show it to you. He handed it to me and I have seen it, and I judge it is a private paper with him; but if he wants you to see it, that is up to him.

Mr. Farmer: I may be in error, but I cannot conceive of papers that counsel on the other side of a law suit hands to the Court are private papers.

The Court: I have told you that I am going to develop this in the course of the examination. That is all I care to hear about it just now. You will please take your seat, Mr. Farmer. (Exception.)

Mr. T. C. Townsend: Your Honor, I want to ask Mr. Sims a few more questions.

Q. Mr. Sims, this afternoon there was a paper here which contained a number of licenses, which had been issued by your office to Fidelity Investment Association to sell insurance, about twenty of them.

A. Twenty-one, I believe.

Q. I will ask you if it is not a fact that those licenses were all returned to your office without being used, and the [fol. 551] five dollar fee paid for each license was refunded by you to Fidelity.

A. At least I ordered it refunded. I assume it was done, because things are usually done which I say shall be done.

Mr. Lauritzen: Was your question directed to those salesmen's licenses?

Mr. T. C. Townsend: Yes.

Mr. Reinhardt:

Q. May I ask: those licenses were issued to the salesmen, not to the company; is that right?

A. The company asks for the licenses for the salesmen; all insurance companies do that. We place the burden on the company to apply for the licenses.

Mr. T. C. Townsend:

Q. These securities that are in your office, or in the Treasurer's office, that you testified about this afternoon; since the institution of the suit here in this Court on June 6, 1941, who, if any one, has been clipping the coupons from the securities?

A. I don't believe anybody has.

Q. Did any one clip the coupons from these securities between April 11th and June 6th, and if so, whom?

A. Perhaps so; but you would have to develop that from the clerks in my office, Mr. Brown and the man in the Treas-

[fol. 552] urer's office. If I understand what you are driving at, you want to know the transactions taking place between the company and the State in that interval? There has been half a million dollars deposited in the Treasurer's office in that interval, but that was in consequence of an agreement with Mr. Young. He withdrew certain securities before I asked for the receivership, and obtained them on the promise that they would be replaced, and he sold them and put new ones in their place.

Q. That was before the receivership took place?

A. No, it was after I had asked for a state receivership here.

Q. That was during the state receivership?

A. Yes.

Q. And during the state receivership, your recollection is that the coupons were clipped?

A. That is my recollection; I might be wrong.

Q. But since June 6th, the time the suit was instituted which brought the matter to this Court, there have been no coupons of any kind clipped?

A. I think not.

Q. Do you know Mr. Young, who is connected with the Fidelity?

[fol. 553] A. Yes, sir.

Q. He advised you a good deal in connection with the securities of Fidelity, did he not?

A. Yes, sir.

Q. Do you have confidence in him?

A. I do. I would add that Mr. Young is not infallible, but he is as good a bond man as I know.

The Court: Mr. Townsend, I want to ask you, in view of Mr. Farmer's request of me, if you will please see that, before this witness is excused, you either prove by him or by some other person the matters referred to in your question about attorneys' fees.

Mr. T. C. Townsend: Who made the request; Mr. Farmer?

The Court: Mr. Farmer made the request, yes, that I show him a memorandum which you had shown me, which I refused to do because of the fact that you requested it not be shown to him. Now, I am asking you that, before the examination is concluded, you produce somebody that will testify about the matters contained in that paper.

Mr. T. C. Townsend: I think I asked this witness about it, and he said he didn't know of the payment of any such attorney fees.

The Court: He said he didn't know; but he might be [fol. 554] able to find out.

The Witness: I don't think so, Judge; because I don't think those things are itemized in detail. It might be found in the audit of last October.

Mr. T. C. Townsend: Your Honor, I will disclose the source of my information. That is the best I can do.

Mr. Farmer: All I asked was to see the paper.

Mr. T. C. Townsend: I will disclose the source of my information to Mr. Farmer's satisfaction.

The Court: Also I want to ask the Auditor this question.

Q. Mr. Sims, in the year 1939, according to Mr. Townsend's question to you, which I assume will later be shown by some sort of proof, there appears to have been a $53,000 fee paid to attorneys in one year. Did not that impress itself on you at all?

A. It certainly did. I don't know that I wrote any formal letters about it specifically, but I talked to the company officials about their extravagance.

Mr. T. C. Townsend: I have no objection to Mr. Sims telling who it was.

The Witness: I don't know, because I was trying to hold them down within their loading for commissions and ac- [fol. 555] counting. I don't know that.

The Court:

Q. Did you make no inquiries from them as to whom they had paid this $53,000 to for attorney's fee?

A. Perhaps I did at the time.

Q. Well, did they tell you?

A. I don't recall; perhaps they did.

Q. Do you think you would have forgotten it?

A. There have been so many discussions about attorneys' fees in New York and here in Charleston and Wheeling and elsewhere, that it is hard for me to remember particularly any specific information or any particular time that such information was given to me, because I have so many things running through my mind that I have to have something to nail it down to before I can remember it definitely.

The Court: All right; is there any further examination of this witness?

Mr. Palmer: Yes, your Honor.

Cross-examination.

By Mr. Palmer:

Q. Mr. Sims, to your knowledge is it not a fact that there was a suit in Detroit brought by the Securities and Exchange Commission against Fidelity, in which quite a num-
[fol. 556] ber of attorneys were engaged by Fidelity to do work for them in that suit?

A. I have some hazy recollection of that, yes, but as to the definite amounts or names of the attorneys, I don't recall anything about that at all.

Q. And is it not further a fact that in 1939 in the northern district of West Virginia, there was a suit brought attempting to have a reorganization or liquidation, or some such matter of the Fidelity company, at which time the suit was strongly defended by the company and carried to the Circuit Court of Appeals, in which a number of attorneys participated in behalf of the company?

A. I recall that suit.

Q. Is it not true, also, that there was between a year and two years' work done in trying to get the company registered with the Securities and Exchange Commission?

A. I don't know how much work was done, but it covered several months.

Q. And you don't know, or would not attempt to state what the services were that were rendered for these various attorneys' fees?

A. No, I am not a judge of attorneys' work, or fees.

Q. And I say you don't know, you didn't see their bills,
[fol. 557] or know what services they did perform?

A. No, sir.

Q. One other thing, Mr. Sims: Mr. Townsend, in asking you about attorneys' fees, got from you, in answer to that question, a reference to the high accounting fees as well, and he said he was not interested in that. Will you tell us about the accounting fees which you protested about?

The Court: I do not think he said he was not interested in it. He said he was not asking the witness about that at that particular time.

Mr. Palmer: I think that is right, your Honor.

A. Yes, I protested it verbally, that there were too many audits. I don't know whether it is one hundred and fifty or two hundred or two hundred and fifty thousand dollars in five years they paid for seven audits or examinations, but it was a huge amount, and I complained about that.

Q. There was as much as seventy-five and eighty thousand dollars paid in one year for auditors' services; isn't that right?

A. Now, I don't want to testify to amounts for I cannot say definitely. I would have to have something to refresh my recollection by, but there were enormous fees paid to [fol. 558] auditors.

The Court:

Q. Who were those people that got that money?

A. Well, at one time they had Wilson & Cross of Cleveland. It runs in my mind that they got about $19,000 for that audit. I appeared up there at Wheeling when the case was on in Wheeling. That is how I know the name of that company. Now, I don't know whether it was Price-Waterhouse or not—don't know whether they examined them or not, but there was another firm that I remember.

Mr. Palmer:

Q. Mr. Sims, I will ask you if you recall this: that after a very expensive audit was made by the company, the Securities and Exchange Commission refused to accept that audit, as not being independent, and required another complete audit immediately following.

A. That is the information I had, yes.

Mr. Palmer: If the Court please, I have not objected to this question of attorneys' fees and audits, but I think it either ought to be gone into fully, or not gone into at all. I cannot see the relevancy of this; but if there is any purpose in it, I would be glad to have it come out now and I would like to have it gone into at this time; but otherwise, I think both the attorneys' fees and the auditing fees are improper [fol. 559] matters within the issues here, and I don't think they should be gone into. I think it is both a waste of time and irrelevant.

The Court: You have heard the Court's request to know certain information. If you have that information, I would be glad for you to tell me.

Mr. Palmer: I do not have any information about either the attorneys' fees or the auditing fees, and I never heard anything about it until Mr. Townsend mentioned it here. Of my own personal knowledge, the first I heard of it was here; so, as I say, I don't think it is relevant and, in fact, I would like to move to strike it out, unless the Court does see something in it where it should be developed as bearing on this question before the Court. If the Court does think it is relevant to go into that matter of attorneys' fees, I do not want to object to it, of course.

The Court: I will overrule the motion to strike, if there is a motion. I want it fully developed.

Mr. Palmer: Very well, your Honor.

Mr. Farmer: For what purpose, if the Court please, is it relevant?

The Court: I have ruled on the matter, Mr. Farmer.

Mr. Farmer: I did not hear your Honor's statement. [fol. 560] Does your Honor think it is relevant?

The Court: Well, the Court does not need to explain all his reasons for letting in or keeping out testimony. I have explained that I want this matter fully developed, and I think you understand why I do want it fully developed, because of a certain question that was propounded by you to the Court.

Mr. Farmer: Your Honor thinks I understand it?

The Court: Yes, because you requested me to give you a paper which Mr. Townsend handed to me, and you then made the statement that you thought you were entitled to see any paper the Court was entitled to see. Now, I say that you are entitled, and so am I, to have the matters fully developed that were contained in that paper; but I did not show you the paper because it was handed to me by Mr. Townsend, and I handed it back to him.

I think we may go ahead with the examination of the witness now.

Mr. Palmer: If the Court please, may I suggest, so that this matter can be developed correctly, that such books of the company, as are needed to show both the accounting and legal fees, be produced, together with a witness who knows the amount of work that was done by both the ac- [fol. 561] countants and the attorneys, so as to be able to judge whether the fees charged by both were fair and reasonable, or otherwise.

The Court: I suppose that would have to be done by Mr. McNulty, or some one, yes.

Mr. T. C. Townsend: Your Honor, I think there is a witness here who can develop this in a short time.

The Court: All right; let us proceed. Is there any further cross-examination of this witness?

Mr. Jaegerman: Your Honor, I would like to ask him a few questions.

The Court: All right, you may proceed.

By Mr. Jaegerman:

Q. Mr. Sims, I have in my hand Exhibit No. 21 in this case which is a mimeographed copy of a bill of complaint which was filed in the Circuit Court of Kanawha County, West Virginia, in the case entitled, "Edgar B. Sims, Auditor of the State of West Virginia, etc. against Fidelity Assurance Association, a Corporation". I show you this exhibit and ask you if you are familiar with it generally,

A. Well, I cannot tell without reading all of that and comparing with the original, because it is not signed by me.

[fol. 562] Q. I show the affidavit, which is an exact copy except that it is printed, of the one you signed.

A. Of course, this is typewritten in, my signature.

Q. It is a mimeographed copy.

A. I assume that it is authentic, but to say that every page is authentic without comparing it, I could not.

Q. Mr. Sims, I will have to ask you to read this bill of complaint, and tell me whether it is the same as the original that was signed by you.

A. Well, it would appear to be a copy of the bill, yes, from examination.

Q. Mr. Sims, are the facts contained in this bill of complaint true as of April 10, 1941, the day you signed and swore to this bill of complaint?

Mr. Lauritzen: Just a moment. I think there is an objection. If the purpose is to make this witness the witness of Mr. Jaegerman, to establish those facts, I don't think he should establish those facts en masse and as a whole, because we would have no opportunity to cross-examine as to those particular facts that he wishes to demonstrate.

Mr. Jaegerman: You will have all the opportunity in the world to go into that. This is an exhibit. It has been [fols. 563-564] in evidence for some time.

The Court: Overruled.

(Exception.)

A. They are substantially correct.

Mr. Jaegerman:

Q. Mr. Sims, are they substantially correct and true as of today?

Mr. Schurr: I think there is an affidavit on the last page of that which states upon what information and belief he made that affidavit. I think that speaks for itself. It states he made it upon information and belief.

Mr. Jaegerman: I don't think it says that at all. It says that the facts contained therein are true, except as to those facts alleged on information and belief, and the witness believes those to be true.

The Court: The objection is overruled.

(Exception.)

A. Yes, sir.

Mr. Jaegerman: Your Honor, I now offer in evidence for all purposes, Exhibit No. 21. I have no further questions of this witness.

* * * * * * *

[fol. 565] Cross-examination.

By Mr. Palmer:

Q. Mr. Sims, I believe you stated earlier that the Attorney General acts as your official attorney; is that correct?

A. Yes, sir.

Q. And that it was his office that had prepared this bill for you to file in the requirements of your statutory duty?

A. Yes, sir.

Q. And you are testifying that the facts of which you have knowledge, as therein contained, are correct to the best of your knowledge and belief?

A. Yes, sir.

Q. Now, isn't it also true tht in the state court proceeding there was no one who appeared in objection to that

proceeding, except one contract holder and no others, during the two months that it was in effect?

[fol. 566] A. I heard of only one contract holder that objected.

Q. You don't know of any more than one contract holder that appeared in objection to that bill in the State of West Virginia?

A. No, sir.

By Mr. Farmer:

Q. Mr. Sims, you were asked concerning a copy of this bill. Now, your affidavit of verification to this bill states that the facts and allegations therein contained are true except so far as they are therein stated to be no information, and that so far as they are therein stated to be on information and belief you believe them to be true. Now, I am asking you, is it a fact that some of these allegations are made of your own knowledge and others are made on information?

A. It may be and it may not be; I don't know, because the bill was worked on so many times by Mr. Partlow, the Assistant Attorney General, and there were certain revisions to be made and so on, so I don't know, without refreshing my recollection, about that definitely. Perhaps it would require a great deal of time to check the sources of information contained therein.

Q. You say it would require a great deal of time to check [fols. 567-575] the sources of information?

A. Yes, because we had to do a lot of checking.

Mr. Reinhardt:

Q. Well, Mr. Sims, in so far as the allegations in this petition are based upon information, rather than knowledge, that is set forth in the petition, is it not?

Mr. Schurr: What page are you referring to there?

Mr. Reinhardt: Page 5.

A. Yes, on page 5 it is stated there about the number of shares outstanding. I had to trust to some of the clerks, and perhaps others, to get the information on the number of shares and contracts outstanding. I did not have that information in the office.

The Court:

Q. The question is, as I understand it, where you made allegations upon information you have so stated in the bill of complaint?

A. I think so; yes, sir.

* * * * * * *

[fols. 576-577] Q. You would not permit them to have any subsidiaries that were not properly managed and conducted, would you?

A. How can the poor Auditor of the State of West Virginia help himself?

Q. Well, were their securities deposited with you?

A. Yes, sir.

Q. Well, you did your best to keep those securities——

A. (Interposing:) I advised against it.

Q. (Continued:) —as clean as possible, and in accordance with the law?

A. I stormed against the subsidiaries.

Q. Well, you have endeavored to keep the portfolio as clean as possible, have you not, and has it not been kept clean?

A. Well,——

Q. Cleaner than most portfolios?

A. Well, it has been cleaned up to a great extent by Mr. Young's buying and selling better grade securities.

* * * * * * *

[fol. 578] Q. Mr. Young and you had been largely responsible for the purchase of those bonds or securities, had you not?

A. Well, the kind he bought did not drop so much, because he had been buying higher grade ones.

Q. But they had dropped?

[fol. 579] A. A good many of them did.

Q. And no one was responsible for that except the drift downward of securities?

A. No.

Q. Now, you particularly mentioned Mr. Messick; and you said Mr. Messick, I believe, drew a large salary, $12,000 a year?

A. Yes, sir.

Q. Do you know over what period of time he drew that salary?

A. No, sir.

Q. Do you know that Mr. Messick only drew about $3500 in all, out of the company, during the several months that he was with the company?

A. Whatever he drew, he drew too much, in my judgment.

Q. You don't like Mr. Messick, do you?

A. I don't like any man who promises to give half a million dollars and then reneges on it.

Q. Do you know that he never promised to give half a million dollars?

A. He told me he was unable to get the money after he agreed to get it, so he must have.

Q. Do you know that Fidelity did not do the thing that [fol. 580] it promised to do?

A. No.

Q. And don't you know that that was the reason why that deal did not go through?

A. I don't know any such thing, no.

Q. Is that the only thing you have against Mr. Messick?

A. I have it in for any man who will welsh on his word.

Q. You say he welshed on his word, and he said he did not.

A. Well, let him bring his $250,000, along with Mr. Rosset's, and put it up, and see if he means business. He never had any $250,000 to put up. I have checked on it.

Q. You have said that the organization apparently, during that period, was very bad and you could not hardly find language sufficiently strong to describe it; is that right?

A. Yes, sir.

Q. Do you have some one else in mind other than Mr. Messick?

A. Everybody that had anything to do with kiting salaries, making advances to salesmen in large sums, which they had not earned.

Q. Who did that?

[fol. 581] A. The majority of the directors. Do you want to know some of them? I can name them.

Q. Yes, name them all.

A. I can name most of them, not all of them from memory: Mr. Reed, Mr. Evans, Mr. Pulfer, Jack Marshall, John Marshall—I don't know who else, I cannot recall right now.

Q. So far as the securities end of the business was concerned, that went along all right during that period except there was a downward trend in values; isn't that right?

A. Nothing wrong with the handling of the securities, as far as I know.

Q. The waste that occurred, you say, was in the management, and in the sales department?

A. Yes, I kept telling them to cut out their expensive offices all over the United States.

Q. And it was in the home office management?

A. Yes, sir; and they would come to me and tell me they were going to do that, that they were just cutting them off as fast as they could, but that they had to maintain these offices during the life of the contract, and a lot of sales propaganda like that, and when it was closed [fol. 582] they still had in Chicago a suite of rooms costing $9,000 a year.

Q. How much would you say was wasted in the management of Fidelity from the end of 1937 to 1940?

A. Well, their records which I examined over here, two experts working on it, show they made an advance of $480,000 in excess of commissions earned and collected.

Q. There has been something said about attorneys' fees—First, let me ask you this: you did not check to see how much Mr. Messick had received, did you?

A. No, sir.

Q. Now, there has been mentioned something about attorneys' fees and auditors who received tremendous sums. You did not check to see what those were, did you?

A. At one time I did check over that.

Q. It has been mentioned that large sums, something like $93,000 was paid out to the lawyers alone in that period. You did not check that either, and you did not know then, and you don't know now to whom that money was paid, do you?

A. Perhaps at that time I did, and perhaps I asked about it, or checked it, because we discussed at length in our office their huge expenditures.

[fol. 583] Q. Do you remember any one else except Mr. Messick that you say was responsible for some of the huge expenditures during that period?

A. Everybody that had anything to do with the voting of that money out.

Q. Can you give me the names of any of the ones that were directly responsible for that?

A. Well, Mr. Risley was president.

Q. You could name him as being one responsible?

A. He was president of the company and he was in my office just before—along during that time, and I landed on him about the four hundred thousand dollars, and he said it was mathematically impossible to run the company on the loading, and I told him it was useless to try to continue the company as it had been going, or I didn't know any mathematics, one or the other.

Q. Now, at the time you filed this suit for receivership in the state court, here in Kanawha County, you filed that in your official position, as you felt at that time it was possible to bring about rehabilitation and reorganization of the affairs of the company, did you not?

A. I did it for the express purpose of stopping the wasting of the money that belonged to the contract holders.

[fol. 584] Q. In other words, you say you brought that suit for the purpose of obtaining control of the affairs of the company.

A. For the purpose of exploration, and to reorganize it or liquidate it, whichever it was necessary to do under the facts.

Q. You had been insisting on having people discharged who had abused their official positions, had you not?

A. Yes, sir, but it did not do any good. I did not get the right ones, or enough of them, I could not tell which.

Q. They were under your complete control?

A. I would like to see anybody in the world control a bunch of incorrigibles like that.

Q. You continued to permit them to do business in the State of West Virginia, and permitted them to go throughout America, and sell these securities throughout America. did you not?

Mr. Palmer: Your Honor, this witness has nothing to do with any place outside of the State of West Virginia. I think this is going a little too far when he goes "throughout America", and I think that should be stricken out.

[fol. 585] Mr. Fleming: He said he had something to do with that, and he evaluated their securities as a whole.

The Court: I think the witness may answer that, if he does have anything to do with it.

(Exception.)

Mr. Fleming:

Q. Do you have anything to do with it?

A. What is the question now?

Q. You continued to permit them to do busines in the State of West Virginia, and permitted them to go throughout America and sell these contracts throughout America; didn't you.

A. Well, we permitted them to do business.

Q. And you did that, knowing all these facts concerning which you have testified?

A. Yes, they would tell me they had reformed, but when they reformed they did not stay reformed.

Mr. Fleming: That is all, your Honor.

Recross-examination.

By Mr. Palmer:

Q. Mr. Sims, you were talking about these so-called "pups" or subsidiary companies. Does the name Marston Company refresh your recollection?

A. Yes, that was one.

Q. How about the name Marietta Company?

[fol. 586] A. Yes.

Q. How about the Paull Company?

A. Yes, that was another.

Q. Were those companies used to hold real estate?

A. Yes, they were used to hold the real estate of the company.

Q. Who held the stock of those companies?

A. The parent company.

Q. They did not put it into any of the funds as securities deposited?

A. I think some of those companies owned some bonds that were deposited to various accounts, real estate mortgage bonds, utility bonds, railroad bonds and the like.

Q. By the statutes of West Virginia, how far does your authority go over these companies, such as Fidelity, other than closing them up when they are insolvent?

A. I would like to know that, myself.

Q. Has there been some question as to the interpretation of the laws of West Virginia, as to whether or not you were legally entitled to crack the whip on them?

A. There has been some question about it, yes.

Q. And you have gone as far as you felt you could go legally, and even further because it was morally necessary [fol. 587] to do all you could?

A. I have gone further than decency and respectful bearing would dictate a man should go at times, in scolding them, commanding them and demanding. I have gone so far as to call them thieves and a bunch of brigands.

Q. Mr. John Marshall, to your knowledge, was one of the large stockholders of the company; isn't that right?

A. Yes, sir.

Q. Did you talk to him about trying to control these men so as to protect his investment as a large stockholder?

A. I think I did on one or two occasions, one at least.

Q. And what was the purport of that conversation?

A. The occasion was when it was before the SEC, when there was a hearing before the SEC in Washington. He came to me and besought me to permit this man, this great man Messick, to continue with the company; and I told him he had more to lose, or his family did, than any other stockholder in the company, and as far as I was concerned, Mr. Messick was out and was going to stay out.

Q. And you were doing that under your official duty as Auditor and not because of any personal feeling you had for Mr. Messick?

A. No, sir; under my official capacity and not dealing [fol. 588] in personalities.

Q. Did you know Mr. Messick personally except through your official duties?

A. I never saw Mr. Messick but twice until today. I saw him twice before today.

Q. And both of those times were on official business, so far as you were concerned?

A. Well, he came to my office after he was out; or he was in the Insurance Department when I walked in and Mr. Justice introduced us and I acknowledged the introduction and walked across the room, turned and came back and told him he was out and was going to stay out; that he had promised to put up half a million dollars and did not do it, but instead attached himself to the payroll at $1,000 a month; that he did not come to fetch the money, but he came to get the money, and that he was out and was going to stay out as long as I was Auditor of the State of West Virginia, and I mean it.

Q. I believe the record does not disclose, but since your first election as Auditor of the State of West Virginia, and since you took office then, you have been continuously in office, and have been reelected to that same office twice at four-year intervals, by the people of the State of West [fol. 589] Virginia?

A. Yes, accidentally so.

Redirect examination.

By Mr. Fleming:

Q. Mr. Sims, you have a difficult position, I think we will all agree, but do all these companies that you supervise, have they all been as difficult to control as Fidelity?

A. No, this is the roughest bunch I ever got hold of. You can't save them from their own folly, in wasting their own money.

The Court: Is there any difference in principle, Mr. Sims, between the large salaries paid to the officers of the company and the large fees paid for legal services and for auditing services? Is there any difference in principle in those things?

A. Both of them show incompetency on the part of the management and lack of mathematical sense, your Honor.

The witness was then excused.

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[fol. 590] H. Isaiah Smith, being recalled as a witness, testified as follows:

Direct examination.

By Mr. Fleming:

Q. State your name, please.

A. H. Isaiah Smith.

Q. Where do you live, Mr. Smith?

A. Charleston.

Q. What is your business?

A. Do you mean at the present time?

Q. Yes.

A. At the present time I am employed more or less in a managerial capacity by the Central Trust Company, Trustee for Fidelity Assurance Association, at its home office.

Q. As I understand, you have been in the banking business and other business?

A. Yes.

Q. And you have especially fitted yourself to handle financial matters, have you?

A. Well, my training has been in financial lines, and my experience.

Q. Now, since June 6, 1941, or a day or two after that, as I understand, you have been employed by the Trustee, [fol. 591] the Central Trust Company, in this proceeding and have been generally in charge of the affairs of Fidelity?

A. That is right.

Q. Now during that period, as I understand, you have been engaged in making a general survey of the affairs of Fidelity, have you?

A. Well, most of our time has been taken up in the office in preparing reports for this hearing.

Q. You prepared the reports for this hearing and the reports that were filed yesterday morning in court by the Trustee, as I understand, each of those were prepared under your supervision; is that right?

A. Yes, sir.

Q. What reports were those, briefly and generally?

A. A balance sheet showing the book assets and book liabilities by funds as of June 6, 1941,——

Q. Do you have that balance sheet with you?

A. It was filed with the Trustee's report as an exhibit yesterday. I could identify it. Then there was a list of creditors, that is, the contract owners, and a list of the names and addresses of the holders of common stock and a list of the names and addresses of the holders of preferred stock.

[fol. 592] Q. And the amount held by each?

A. And the number of shares held by each, and the list of unpaid bills as of June 6th; a list of outstanding checks, and then a schedule showing the market value as of June 6th of the securities held by the various funds.

Q. Does that show the location of those securities, Mr. Smith?

A. The state in which located, yes.

Q. Do you have that available?

A. It is filed with the Trustee's report.

Q. Is that in the Clerk's office?

Mr. Townsend: It is right there in that file.

Mr. Fleming:

Q. You may proceed, Mr. Smith.

A. From my recollection that covers the contents of the report of the Trustee filed on yesterday, the various exhibits.

Q. You mentioned the list of contract holders. Can you tell the Court the number of contract holders in Fidelity at the present time?

A. I think it is approximately 80,000; maybe it is a little less.

Q. And distributed over how much territory, would you say, Mr. Smith?

[fols. 593-604] A. Over practically every state. They are not broken down by states, you understand, but I should think that the addresses from that list would reveal owners of contracts in probably every state in the Union.

Q. And in Canada?

A. Possibly in Canada.

Q. And in foreign countries also?

A. Possibly so. I am saying you would have to make an examination to reveal that. I did not examine it from that standpoint, however.

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[fols. 605-606] Mr. Fleming:

Q. Mr. Smith, you came into the affairs of Fidelity as one of the receivers in the state court proceeding, as I understand?

A. That is right.

Q. And you have been in this work since April 11, 1941?

A. Yes.

Q. Were you employed in any capacity with Fidelity prior to that time?

A. No, sir.

Q. But since that time you have given practically all your time, have you not, to the affairs of Fidelity?

A. I have. That is, I have as one of the receivers and then as an employee of the Trustee.

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[fol. 607] Q. From the knowledge which you have gained in this position in which you have been working, and from

your general experience and knowledge, I will ask you whether in your opinion it is possible to have a rehabilitation or reorganization of Fidelity.

A. That has been my only thought since I have been appointed by the state court.

Q. You feel that can be done?

A. Yes; and of course, during the trusteeship I have been doing such work for them as they desired to have done.

Q. In other words, during the state court receivership your activities were partially directed at least towards considering the working out or developing of a plan of rehabilitation?

A. Of course, we did not have time to get to it but that is [fol. 608] what we did have in mind, definitely.

Q. And you still have that in mind, have you not?

A. Yes.

Q. Do you think it could be done?

A. My personal thought?

Q. Yes.

A. Without attempting to qualify as an expert, and without attempting to say what sort of plan, in my opinion with the assets the size that Fidelity has, a reorganization of some sort can be done.

Q. From your contact with the contract holders, what would be your judgment in reference to working out with them a reasonable and equitable plan which would protect the rights of the contract holders?

A. Such contacts as I have had, the contract owners are in a fairly good frame of mind. I mean by that, that a great many—I am not trying to give any percentage but a great many—have indicated a desire to see a reorganization.

Q. Do you feel there is a place for Fidelity in the business world and for its rehabilitation and continuation?

Mr. Palmer: I object, your Honor, because the question asks is there a place for Fidelity. I don't think he means that. I think he means for the sort of company—for some [fol. 609-626] sort of company, and I would rather he would state some sort of company, whatever he has in mind, than Fidelity, just using that description for whatever may be reorganized.

The Court: Well, it depends on what he does mean. If he means there is some good will attached to the name,

then the question is proper; if not, I think it ought to be framed otherwise.

(Question read to the Court.)

The Court: The objection is overruled to that question. (Exception.)

A. In my judgment a company selling such forms of investment contracts as Fidelity has in the past would have a rather difficult time in that same form of contract. Now, with probably a modified type of contract sold or attaching to it some other feature to fit into the economic period we are in now, why, I would say without qualifying my answer that it would be possible.

* * * * * * *

[fol. 627] Q. I was speaking of the company as a whole and not attempting to allocate them to the various funds.

A. Yes.

Q. Now, with reference to reorganization, I think I copied your words down when you said you believed reorganization of some sort can be done. Is that substantially what you said?

A. Yes, that is a pretty broad term, I expect.

Q. Now, you have had some two months' experience as a state court receiver, and have had approximately the same time as an employee of the trustee in this proceeding; is that not right?

A. Yes.

Q. As such you have had some little chance to study the working of Fidelity although your main employment has been in trying to gather the various funds together and to get reports up on them.

A. That is right.

Q. Now, when you say reorganzation of some sort can [fol. 628] be done, you are using that purposely in a very broad sense, are you not?

A. I am.

Q. You are not attempting to state you believe there can be 66⅔% of the creditors or contract holders, either as a whole or of any one class, who can or will agree to any specific plan, are you?

A. Of course, I could not answer that question without knowing something about the plan. I don't know what

they are going to do, and even any kind of plan we might finally think is good I don't know who will accept it and who will not.

Q. It is your conviction, is it not, Mr. Smith, that with the present economic situation and the present yield that a company can get from investments in stocks and bonds, that any company has difficulty in making as much as 3% yield net on its investment; isn't that right?

A. You say, as much as 3%?

Q. Yes.

A. No, some of the life insurance companies are improving their reserves, I think, 3½%. I cannot qualify as an expert on this but it is my understanding some of the investment trusts are having a yield probably in excess of 3%—earn a yield in excess of 3.

[fol. 629] Q. Let me put it another way, Mr. Smith: I believe you said on your direct examination that you did not believe at the present time that face amount securities could be sold profitably by any company which could be reorganized at the present time; is that correct?

A. I believe I qualified it by saying a company that attempted to sell exclusively face amount certificates probably would have some tough sledding.

Q. One of the reasons they would have difficulties would be in the requirements of the Investment Company Act of 1940; is that right?

A. I am not familiar enough to talk about that.

Q. Do you know whether or not such a company would at the present time have difficulties in qualifying and getting licenses from the various proper legal bodies in the various states in which they would attempt to go?

A. I wouldn't know how to answer that.

Q. When you were a state court receiver, or during the period in which you were exclusively a state court receiver,—you may still be, Mr. Smith—but from April 11 to June 6 isn't it a fact that you had this thought in mind, that even if 40% or 50% of these persons who had the approximately $25,000,000 fund could be gotten together to [fol. 630] form some kind of an organization for their own benefit, that it would probably be to their best interests rather than a forced liquidation?

A. Any appreciable amount of—a concern with assets such as Fidelity, any appreciable number who could work out some scheme to keep from forcing those securities on

the market, certainly, I think, would reflect to their advantage. I say an appreciable amount. I would not want to fix the percentage.

Q. An amount large enough to make it worthwhile?

A. Yes.

Q. And was it not your idea that the best way that could be worked out would be through some form of life insurance company with perhaps the selling of annuities as a minor part of that?

A. Frankly, I had thought about a good many angles but to come down to saying what—to begin to talk about plans, I did not have time to do it.

Q. Mr. Smith, is it not true that in the state court proceedings in the State of West Virginia only one policyholder came in and protested against those proceedings, and that policyholder intervened only for the purpose of asking to be informed as to what the plan of reorganization would be?

[fol. 631] A. That is true.

Q. And did not come in to protest but came in and asked to be informed before anything was ultimately done?

A. That is true.

Q. In the letters you received at that time from contract holders, is it not true that the general tone was one of inquiry without criticism as to what was going to take place and how they were going to be affected by it?

A. Yes, I would say, of course, these people who have money invested are naturally just like we would be. They want to know what is going to happen. To analyze those letters with any degree of percentage as to what they say is hard to do. Here will be one that will say he doesn't want insurance; another will say he will go along; another will say he wants reorganization or something else, and it is pretty hard to classify a general answer as to that.

Q. Can you tell us from your knowledge of the workings of the company whether or not during the time since information has been given broadcast that the company is under a chapter 10 proceeding there has been a gradual diminishing of the payments by the policyholders into the offices of the company?

A. I would say it has been gradual since the first court [fol. 632] proceeding. I mean the April proceeding. There has been more or less gradual decrease ever since.

Q. And I believe it was approximately $280,000 that was paid in during that two months, and approximately $100,000 during the last two months, which shows about the ratio of decline in the payments by the contract holders over that period of four months' time?

A. That is what the record will show, yes, that we have collected during that period.

Q. I say, does that give a fair indication of the rate of decline of the contract holders to pay in under their contracts?

A. That is exactly what has happened, yes.

The Court:

Q. Mr. Smith, is it true or not that the contract holders have been advised, in effect, that their rights would be the same whether they continued to pay in or did not?

A. That is right. That is a quite interesting thing, if I am permitted to make an observation.

Q. All right, go ahead.

A. A very large amount of our inquiries will say they don't see any need of paying in if their interests are not going to be jeopardized, that they won't pay any more. [fol. 633] Now, that would account for the dropping off considerably in payments, I should think. To be safe, we advised them that, under the state court receivership, that is, their equities were fixed as of April 10, whether they paid in or not; and the Trustee has taken the same position that their equities were frozen as of that date and they would not lose their equities by stopping their payments.

Mr. Palmer:

Q. Mr. Smith, in the answer filed by the Auditor of the State of West Virginia, on page 22 thereof, there is a certain table or chart setting forth the various states in the left-hand column, and across the top it shows the various series of contracts or contract series of Fidelity, and in one column opposite the states named is an "L," indicating contract liability to contract holders residing in that state, and the letter "D" is used to indicate that securities belonging to the pertinent contract fund have been deposited in such state. Will you take that table and check it with the schedule of securities deposited by funds on

April 10, 1941, and see if it is not true so far as you can tell that that schedule on page 22 is correct?

The Court: Are not both of these papers in evidence already?

Mr. Palmer: The answer is in evidence, sworn to by [fol. 634] Mr. Sims. If I can have an understanding that no one will object to its accuracy, with the right, however, if they find it inaccurate to object to it, I will be glad to introduce this in evidence without anything further, your Honor.

The Court: What I am driving at is this: Is the paper with which you are asking to have the answer compared, also in evidence? Are not both of them in evidence?

Mr. Palmer: No, sir.

The Court: Can it be put in evidence?

Mr. Palmer: I am afraid not. It is a paper I could not very well prove but which has been made up and with which this witness is familiar and it will refresh his recollection.

The Court: All right.

Mr. Palmer:

Q. Is that correct?

A. Yes, sir, I can verify that schedule as being correct.

Mr. Palmer: Now we offer to introduce in evidence page 22 of the "Answer and Controversion of Edgar B. Sims, Auditor," etc. I think it is a part of the record but we want to introduce it now as being correct.

Exhibit No. 28 Filed

[fol. 635] Q. Mr. Smith, your answer is based upon information obtained by you, which has its source as the books of the Fidelity Assurance Association; is that correct?

A. Yes, sir.

Q. It is correct, is it not, that you and Mr. Ross B. Thomas were acting as state court receivers when this present proceeding was brought?

A. That is right.

Q. And were you gathering the assets as far as you were legally able to do so into your possession as such receivers?

A. That is right.

Q. And if there had been no reorganization were you and Mr. Thomas capable of going ahead and liquidating those assets and making such distribution as the Auditor would require?

A. You mean, the assets in our hands?

Q. Yes.

A. Oh, yes.

Q. And were you at all times working with the Auditor of the State of West Virginia on his part of the administration of the estate?

A. Yes.

[fol. 636] Q. And you were also working under the guidance and direction of the Circuit Court of Kanawha County, West Virginia, were you not?

A. Yes.

The Court: Mr. Palmer, there is one thing the Court would like to get straightened out in its own mind as to the position you are taking in this suit here. As I understand, you represented the receivers in the state court proceeding, and Mr. Smith as one of the receivers says that his whole thought in the matter was to try to effect a reorganization, and I presume that you as his attorney in that matter were one with him in that thought. Now, you are appearing here and from your questions it seems that you are endeavoring to prove that there is no possibility of any reorganization. That appears inconsistent to the Court and I would like to know what the explanation of that is, Mr. Palmer.

Mr. Palmer: I think that is a fair question and I will be more than glad to state my position on the record, your Honor. If the Court please, I understand this: that under this table just introduced in evidence as Exhibit No. 28 there are 15 different states which required deposits and 20 states where the debtor was required to obtain a license, [fol. 637] and there were some seven to nine different contract funds and series in these various states, so taking each one for one it adds up to a total of 117 classes of creditors. Now, it is my opinion that it is impossible at this time to obtain the consent of two-thirds of each of these classes of creditors to any plan of reorganization that can be presented. In the second place, it is my opinion that no plan can be formulated which this Court will approve which will have the approval of that number of

creditors. However, I do feel that there are a large number of contractholders who would prefer, as Mr. Smith and others have said, some form of company whereby periodic installment savings can be made; that they like the idea and are willing to continue it, and it is my personal belief as counsel, and having talked to some others about it, that if a group as large as, say, $10,000,000 or 40% would approve of such a plan, or 50% that in state court proceedings they voluntarily agree to that, that then an insurance company could be formed by their voluntary agreement which could do that; that, however, the Federal Court's hands are bound by Chapter 10 proceedings and unless two-thirds agree, even though 40% or 50% or 60% would agree, the Court would have to reject the plan, and I [fols. 638-660] sincerely feel and I think that the state court receivers feel that in state court, particularly prior to the bringing of this suit, there was every possibility and likelihood of a very substantial part, a large enough part to make it worthwhile, of these contractholders agreeing to some plan among themselves for voluntarily keeping this going and not having at the very last a forced liquidation.

The Court: Did you then, and do you now, consider that such a reorganization on the part of any percentage of the contractholders is beneficial to them?

Mr. Palmer: Yes, sir, I do.

The Court: Then your only doubt, and your only question, is as to the possibility of getting a sufficient percentage to agree?

Mr. Palmer: Yes, that is correct, your Honor.

* * * * * * *

[fol. 661] The Court: Either you misunderstand the allegation of the petition or the Court does, Mr. Farmer. I have been able to see nothing in the petition which says that any vested rights of any contractholders are to be modified or need to be modified. My understanding of the allegation of the petition is that the contracts, the executory contracts of the company, contain provisions that the company cannot meet, and that in order for any reorganization those executory contract provisions must be modified; but certainly there is no indication there that any vested rights in any deposits are going to be affected at all, and the Court would not permit that if there was any such thing contemplated. Whatever vested rights the contract-

holders have in any deposits are going to be protected right through this proceeding. Now, it is true we have not yet [fols. 662-674] got to the point of determining what those vested rights are. That will come at a later stage of the proceeding, but certainly they are not going to be divested in any way.

[fol. 675] Mr. Huwe: Another thing I would like to bring out, your Honor, I would like to have some testimony introduced as the financial standing of Fidel of New York, the purpose being since the question of reorganization is involved here whether this company can go on as a face amount certificate company. Now, if Fidel of New York is able to do such business, is in good shape, why cannot at least Fidel be organized on the same basis and condition? I think it is pertinent, and we have evidence with respect to that likewise, to show the feasibility of some plan.

Mr. Court: We will see about that later. Mr. Fleming will be here shortly, I understand.

Mr. Huwe: I take the attitude of representing certain creditors who may want reorganization. We want to investigate and see what is going on; although we filed pleadings denying the jurisdiction of this Court we have a right to examine the merits and I want to see both sides.

The Court: I will give you every right to develop your [fol. 676] position.

Mr. Gray: Your Honor, the issues are made up here by the answers and the petition. I wonder if we can proceed now to take the evidence upon our issues so that counsel from distances might get through?

The Court: The Court will look after that.

Mr. Gray: I realize that, your Honor, but I thought perhaps we were imposing on the Court a little.

The Court: I have been helped somewhat by the statements made and I will say that I want to get what light I can on the situation, at the same time we are going to hurry it along. I think you have all observed that I have been doing that. Are there any more questions of this witness?

Mr. Palmer:

Q. Mr. Smith, other than the deposit with the State of West Virginia in the City of Charleston, are there any

other assets to your knowledge of Fidelity in the Southern District of West Virginia?

A. Did you fix the date?

Q. As of June 6th.

A. Yes, there was some furniture, a small amount, I don't know the value, but a normal amount in the branch office here in Charleston, and I think some of the furniture was stored in Bluefield.

[fols. 677-679] Q. Let me rephrase it: Were there any other substantial assets?

A. In May the receivers had transferred some cash—opened accounts in banks here in the City of Charleston to the extent of about $380,000, I believe, approximately.

Q. That had been transferred by the receivers from other banks into the City of Charleston?

A. That is right.

* * * * * * *

[fol. 680] Mr. Farmer:

Q. Did you bring those copies of those letters or communications from the receivers and from the trustee to the contractholders that you were requested to furnish?

A. Yes.

Q. May I have those?

A. Do you want them from the stand now or when I am through?

Q. I would like to see them now.

A. All right (handing papers to counsel).

Mr. Farmer: Your Honor, I would like to introduce in evidence and have them marked certain letters. First, I offer this letter from Edgar B. Sims with reference to Fidelity.

Exhibit No. 29 Filed

The Witness: If the Court please, that letter just filed was sent out as an enclosure in a letter mailed out by the receivers.

Mr. Farmer: Which letter just referred to by the witness, I now offer as Exhibit No. 30, if the Court please.

Exhibit No. 30 Filed

Mr. Farmer: If the Court please, I now offer as Ex-
[fol. 681] hibit No. 31 a letter from the witness and Ross

B. Thomas, dated April 18, 1941, with a statement of the receivers attached thereto, as Exhibit No. 32.

Exhibits Nos. 31 & 32 Filed

Mr. Farmer: Next, your Honor, I offer in evidence as Exhibit No. 33, a letter from Central Trust Company, Trustee, dated July 3, 1941, which contains a notice from the Trustee dated June 26, 1941, together with a form of some sort, an application for return of payments, and a special notice attached. I offer those collectively as one exhibit.

Exhibit No. 33 Filed

Q. Now, Mr. Smith, were those all the form or circular communications sent out by the receivers or trustee?

A. That is right.

Mr. Reinhardt: If the Court please, with respect to Exhibit No. 32, may I inquire for what purpose that is introduced in evidence?

Mr. Farmer: I just wish to introduce in evidence all the communications from the receivers and the trustee to contractholders. There has been testimony here about what they wanted and what they said and wrote. I just want to show what was said to them.

Mr. Reinhardt: In other words, this is introduced in evi-[fol. 682] dence merely for the purpose of showing that such communication was sent?

Mr. Farmer: Just to show both sides of the conversation or communication.

Mr. Reinhardt: Do I understand you mean by that to answer yes to my question?

Mr. Farmer: I think I have answered the question.

The Court: You can answer that question. What is the use of burdening the record by a lot of unnecessary colloquy? Mr. Reinhardt wants to know whether the purpose of this is to show that these contract owners received that sort of communication, or for what purpose, if not for that purpose.

Mr. Farmer: Yes, to show they received them.

Mr. Reinhardt: Then there is no objection, your Honor.

Mr. Palmer: If the Court please, rather than ask a question to Mr. Smith, it may be by addressing myself to the Court I can save several questions. Am I correct in my un-

derstanding that the evidence introduced to this point has shown now that the liabilities to contractholders as promised by the debtor are greater than the assets that the debtor has in such an amount that has been proven; that there is no interest now and has been none of June 6th of the stockholders in the debtor corporation any longer in a [fol. 683] financial way?

The Court: That there is no what?

Mr. Palmer: Is no interest on behalf of the stockholders in the debtor corporation.

The Court: I think the evidence has shown that the company was insolvent. Mr. Sims' evidence shows that.

Mr. Palmer: Perhaps I had better ask a question then.

Q. Mr. Smith, from your records, is it not true that, as shown by the records of the company, the company has far greater liabilities to its contract owners than it has assets with which to meet those liabilities as of June 6th?

A. Mr. Palmer, does your question mean by funds or by the total of all funds and total assets of all funds and the total liabilities of all funds?

Q. That is correct, the latter part of it.

A. Based on the market value as of June 6th of the securities, and using the book value of other assets, some of which I feel reasonably certain are the books values in in excess of the market value, the total liabilities of all funds, including the general fund, is greater than the value of the total assets of all funds, including the assets of the general fund.

Q. By approximately how much money?

[fol. 684] A. That is difficult to answer, in that we have never made what you might say was a consolidated statement of the total assets and total liabilities, because we have always treated them by funds. We look on the solvency or insolvency by funds rather than the solvency or insolvency by total assets or total liabilities.

Q. Would the Auditor's statement of approximately two and a half million dollars be substantially accurate?

A. In my judgment it probably exceeds that a little bit.

Q. You have included in your total assets any and all capital and reserve of the company; is that correct?

A. Oh, certainly so.

Mr. Palmer: That is all, your Honor.

Redirect examination.

By Mr. Fleming:

Q. Are there funds of Fidelity that are solvent?

Mr. Palmer: What do you mean by "funds of Fidelity that are solvent"?

Mr. Fleming: I mean classes, for instance, Series B income contractholders, and Series D.

The Court: I gather the question refers to the funds the witness spoke of a few minutes ago in saying that he classi-
[fol. 685] fies the financial situation with reference to funds.

A. There is one reserve fund that I can say is solvent, yes.

Mr. Fleming:

Q. What is that?

A. Series D.

Q. That is the last fund, as I understand?

A. Yes, that was.

Q. As I understand it, Series C is also solvent?

A. The Series C is small.

Q. Only has one or two contractholders in it?

A. I think so. It has a liability of $600—approximately that, six-hundred-odd—cash in the bank of about four thousand and something. We don't think of Series C hardly as being in the picture. The only asset they have is cash of about four thousand.

Q. You only have out one contract at the present time?

A. I think so, yes.

Q. What about Series B?

A. When we get into Series B, I want to make this plain, there are certain of these assets here that I am not able to obtain the market value on, which would make it difficult to evaluate them. There are certain assets in Series B, real estate, that until I would have an appraisal as to what
[fol. 686] that would be; I would be unable to state the solvency or insolvency of that particular fund.

Q. It might turn either way, as I understand?

A. That is right.

Q. What about Series A?

A. Series A has some money coming to it from other funds, and their ability to return that money to Series A

would make an appreciable difference in the solvency or insolvency of that fund.

Q. And you refer particularly to the inter-fund loan?

A. That is right.

Q. And particularly the loan of the special income contract?

A. That is right.

Q. That is the oldest, I think, is it not?

A. That is right.

Q. Of the outstanding contracts?

A. Yes.

Q. What about the special annuity contracts.

A. The special annuity contracts, you would run into inter-fund loans again there. Even on the assumption they are worth—that they would be returned in full—the annuity fund based on the figures as submitted in the balance sheet, [fol. 687-695] is insolvent.

Q. By about how much, would you say?

A. I cannot say. There are a good many contingencies depending on the value of certain real estate owned by that fund.

Q. But so far as the special annuity fund, Class A, Class B, Class C, and Class D funds are concerned there is not a great degree of insolvency, is there?

A. No, —well, Series A, there is a contingency there to determine the amount. Series A is not solvent, in my opinion, based on the figures as submitted in the balance sheet. Series B is pretty close to being sound, and Series D is all right. The annuity fund is insolvent.

Q. And the special income fund is, of course, insolvent?

A. Yes.

Q. As I understand, the special income liability was under a million dollars to contractholders?

A. Yes, I think the reserve liability, speaking off-hand—that is in the balance sheet, however—I think it is in the neighborhood of $818,000.

* * * * * * *

[fol. 696] Mr. Fleming:

Q. Would it be possible or practical for each of the states with which securities of Fidelity are now deposited under the various state depository laws, to liquidate those assets

without a great deal of assistance from the home office in the State of West Virginia?

A. Do you mean to liquidate the assets and make the distribution out to the contract owners?

Q. Yes, in each state separately?

[fol. 697] A. I would say as a practical problem it would be most difficult, because the records and the liabilities by contract owners are in the main office, and so far as I know that is the only place whereby the accurate information could be obtained.

Q. From a viewpoint of expense, would it be more expensive or less expensive, in case of liquidation, for liquidation to occur separately in each of the individual states rather than from one central point, and particularly the State of West Virginia?

Mr. Palmer: We object to that question. This Court can not entertain this position and take jurisdiction on any such ground as that. The petition has been filed for reorganization and the petitioner has to carry the burden of showing that there can be a reorganization, and the fact that—if it be a fact—that liquidation might be a little simplified or some less expense by this Court's taking jurisdiction and later ordering a liquidation, certainly would constitute no ground for an order now sustaining the petition as properly filed and holding that the Court has jurisdiction.

The Court: Overruled. (Exception.)

Mr. Fleming: The debtor takes issue, of course, with the position stated by counsel.

[fol. 698] A. Mr. Fleming, I think it would be most difficult for me to state as to the expense of liquidation. I don't believe I could answer with any degree of intelligence as to that at all. As a matter of fact, I never thought about it.

Q. In other words, you cannot state whether or not with, say, 15 state receivers working in separate states endeavoring to liquidate, and the home office here working with them, endeavoring to help each of them liquidate, you cannot say whether that would be more expensive than just one?

A. Oh, it probably would be, but as to saying how much, I don't know the state laws or the amount that the courts might allocate in the way of fees, and so on.

Q. There is an excess of securities in the State of West Virginia, as I understand, amounting to about four or five

million dollars over the liability to contractholders living in the State of West Virginia; is that right?

A. Substantially, yes.

Q. What about the liquidation of that fund covering the rights of the states under their state statutes in that fund? Would it be practical to liquidate, say, in the state court of West Virginia covering all these funds?

[fol. 699] A. I think that is a legal question, Mr. Fleming.

Mr. Farmer: I object as calling for a conclusion of law, your Honor.

Mr. Fleming: I think it might call for a conclusion of fact also, but I don't insist on the question.

The Court: All right.

Mr. Palmer: May I ask if the debtor's purpose in these questions is to show that liquidation would be simpler in your Honor's court than it would in other courts? I have not objected but I would like to know the purpose behind the questions, if I may.

Mr. Fleming: Very frankly, I will say I think it would be much more practical; in the first place, you have the central authority under the jurisdiction of which these various legal questions could all be determined, and in case of liquidation you have a central authority under which that liquidation could be supervised. From a reorganization viewpoint, certainly, I think that reorganization would be practically impossible in the light of these legal problems that exist in this proceeding to reorganize under any other situation.

The Court: It seems to the Court those are very pertinent questions, because of the fact that one of the pro-

[fol. 700-705] visions of the statute with reference to good faith is that it is not filed in good faith if a prior proceeding is pending in any court and it appears that the interest of the creditors and stockholders would best be preserved in such prior proceeding, and it strikes me that is very vital here.

Mr. Fleming: That is a matter this Court must determine from all the facts, evidence and conditions in this case.

Mr. Palmer: I was not objecting. I was just asking the purpose. I think the Court is right.

The Court: Mr. Farmer, however, made the objection and what I said is mainly in reply to his objection.

Mr. Fleming:

Q. You cannot answer the question then, Mr. Smith?

A. I believe I would answer it by saying in my opinion it was a legal question.

Q. Is that your only answer to it?

A. I think that is the only answer I could give,

. . . . . .

[fol. 706] Q. Now, one other thing: Have you in your work for the Trustee, or during your work as a state court receiver, made any investigation as to the advances made to the various sales forces throughout the period of the last five years, or any part of it?

A. I have not gone into that as thoroughly as I contemplate.

Q. Have you gone into it to some extent, enough to give us some idea of that?

A. I know there are on the books outstanding certain advances that have been made to the sales force.

[fols. 707-708] Q. And those advances have been made and have not been repaid, is that right?

A. The balance sheet as of June 6th will show an amount that has been advanced to salesmen, I mean to employees.

Q. Will you give me that amount, roughly?

A. I think the large amount—I am speaking now from the impression I have—that a great portion of these advances to salesmen has been charged off and is not reflected in the balance sheet, of course, of June 6th.

. . . . . .

[fol. 709] By Mr. Lauritzen:

Q. Mr. Smith, a question was asked by Mr. Fleming a moment ago as to whether, if the funds of Fidelity were to be liquidated in the various states where they are deposited, whether it would require a good deal of cooperation on the part of the home office, and I believe your answer was that it would. Now, to break that down a little bit, do you mean that for the states to sell those securities and realize cash on them it would require cooperation of the home office of Fidelity?

A. No, I believe I enlarged my answer, and Mr. Fleming agreed that is what he meant when he said liquidation.

I said did that mean to liquidate the assets and distribute them out, and he said that was what he implied in the question. So just to sell the assets, I think, if it is legal for them to be sold, why, of course, they are in their hands and they are in negotiable form; but to distribute the proceeds, I repeat, would be difficult and might be absolutely impossible without having the records of the home office, Mr. Lauritzen.

[fol. 710] Q. Let me ask you this: If it became necessary to liquidate the various deposits out in the various states, and in the State of West Virginia, to satisfy contract-holders who have a right to have their cash out of those deposits if they want it, and you being one of the West Virginia receivers, if the State of Wisconsin would ask you for certain information or to make available certain records in order that Wisconsin officials might perform their duties in that respect, would you be disposed to assist those officials and make those records available to them?

The Court: Don't answer that question. That is an improper question and I rule it out.

(Exception.)

Mr. Lauritzen: If the Court please, we think this would be quite important as bearing on the issue of whether liquidation in federal court or state court would be more expeditious or efficient.

The Court: Do you mean as to whether Mr. Smith would be willing to give his cooperation?

Mr. Lauritzen: Yes.

The Court: Well, Mr. Smith is just holding that office of receiver by appointment of the court. He may be discharged tomorrow and another receiver appointed, and when you ask Mr. Smith about what his personal attitude [fol. 711] would be toward it you have not helped the Court in any way to know what the real situation is.

Mr. Lauritzen: On the assumption that he would be continued in office.

The Court: Well, no such assumption can be made. That is a question of personality.

Mr. Lauritzen: May I ask it this way: Without respect to yourself individually and personally as a receiver, whether to your knowledge any state court receivers who might be appointed here would not be willing to cooperate

with state officials in Wisconsin or elsewhere to assist them in the performance of their duties, if liquidation in those states became necessary.

Mr. Fleming: The debtor objects.

The Court: Mr. Smith could not possibly know that, and you know he could not know it, so I am going to ask you not to propound any more such questions as that. It simply takes up time and does not do the Court any good. I want such matters brought out as will assist me in determining these questions, but I don't want to sit here and have questions like the last question propounded to any witness. I want the attorneys to govern themselves accordingly, because that is a question that any attorney, I don't care who [fol. 712] he is, ought to know this witness could not answer.

(Exception.)

Mr. Palmer: Your Honor, may I ask it in a different form?

Q. Mr. Smith, while you and Mr. Thomas were state court receivers and other states had receivers in one form or another, was there cooperation between the various states and between you as receivers of the Circuit Court of Kanawha County?

The Court: There is no objection to that question.

A. In what way do you mean, cooperation?

Mr. Palmer:

Q. Cooperation in working at all times towards solving the difficulties in which Fidelity was in; making information available to each other and general cooperation towards the ultimate lines you had in mind?

A. Well, we were friendly between each other. That is, we had two or three conferences with some of the other state court receivers, and we asked them to cooperate with us and they said, of course, they would do all they could. They asked us for lists of contract owners, which we did not feel ought to be sent out at the time and we did not send them out, and some of them got quite "sore" at us, I think, and probably are still, but we did not make those available because we did not feel it was the proper time to [fol. 713] distribute out generally a list of contract owners which was under our supervision and to which we were

responsible to the court of our appointment to protect the interests as far as we could of Fidelity as a whole.

Q. That particular phase of it was so that perhaps those who should not have those lists would not obtain them; is that right?

A. Yes, that would have some bearing on it.

Q. And isn't it true that after the state court receivers were appointed here the other states were notified of that and asked to take appropriate steps to protect the interests of Fidelity in other states—a telegram sent to each?

A. I have seen copies of telegrams the State Auditor sent various states asking for the appointment of—asking that they take the proper steps to protect the assets in this state and the appointment of ancillary receivers.

Q. Isn't it a fact that you and Mr. Thomas, as state court receivers, have cooperated in that information which you felt was proper to be given other states, and have given that information to the proper officials?

A. That is right.

Q. And isn't it a fact that information they felt was [fol. 714] proper and necessary to your receivership they gave to you?

Mr. Fleming: I object as leading and suggestive.

Mr. Palmer: I agree, but I am trying to hurry along, as the Court requested.

A. I don't recall it being necessary for us to ask for any information. There could have been some minor matter, but nothing of importance.

Mr. Palmer: That is all I care to ask, your Honor.

Redirect examination.

By Mr. Fleming:

Q. Is it not a fact that the only cooperation you received, or could have received from these other states, was to permit them to go ahead and sell the securities of Fidelity deposited in those states and distribute the assets to their own contract holders, without regard to the rights of contract holders outside of those respective states?

Mr. Lauritzen: I think you should change the question. He asked if it was the only form of cooperation they could have received, your Honor. If he will ask whether it is

the only form of cooperation they did receive, I will have no objection.

The Court: I understood that to be the question.

A. Do you mean to put it, as a court receiver did I [fol. 715] think that was cooperation by their selling the securities?

Mr. Fleming:

Q. No, I mean that was the only cooperation you received from these other states.

A. Well, I don't classify that as cooperation, if they attempted to liquidate the securities.

Q. I don't either; but can you answer the question?

A. Well, I thought that answered it. I don't construe that as cooperation when they sell the securities they are holding in their states.

Q. Well, that is what Wisconsin did, did it not?

A. In the State of Wisconsin they brought the proceeding to liquidate, which we opposed by counsel, but the order was entered to proceed with liquidating of certain portions of the securities.

Q. Over a million dollars worth of Fidelity securities in Wisconsin were sold; isn't that right?

A. I think they are going to convert—they changed the form of the assets. They changed the form of the assets from bonds over into cash.

Q. From interest-earning securities to cash?

A. That is right.

Q. Any interest being paid on that cash, if you know?

[fol. 716] A. Not to my knowledge.

Q. Were securities sold in any other states?

A. Not to my knowledge.

Q. On Tuesday or Wednesday I requested you, if you could do it, to ascertain the value of the assets of Fidelity situate in the northern district of West Virginia. Were you able to do that, Mr. Smith?

A. Some records are in from Wheeling, or will be in today, which I hope will show that.

Q. They will be available this afternoon, you think?

A. I think so.

Mr. Fleming: That is all, your Honor.

Recross-examination.

By Mr. Lauritzen:

Q. With respect to the Wisconsin proceeding, are you not aware that the statutes under which Wisconsin acted provide for a rehabilitation in the State of Wisconsin, and that was expressly recognized by counsel for the Fidelity and the Attorney General's office in the conduct of those proceedings?

A. The receivers received a letter from the Banking Commission, I believe, of Wisconsin, in which they pointed out [fol. 717] that they were going to get in the claims of the contract holders, and they gave us until, I believe—they said they would withhold any actual distribution until June 30th, gave us until that time to submit a plan or go over a plan with them.

Mr. Reinhardt:

Q. What was the date of that?

A. We were given until June 30th.

Q. When were you given until June 30th?

A. Oh, it had to be, following the chain of events, after the 15th of May; I would say near the 25th of May on which we were given notice that on June 30th the plan was to be submitted.

Mr. Lauritzen:

Q. To recall a little bit further on that, isn't it true that it was agreed between counsel for Fidelity and the Attorney General's office that we would wait until June 30th before we sent out claim forms, because obviously we could not distribute any money before we knew the persons that had it coming to them, and in what amounts?

A. That is right.

Q. That would take a long time, would it not, to ascertain those facts?

A. Yes.

[fol. 718] Q. Now, with respect to the sale of a million and a half dollars worth of securities, are you aware that that was done with the express consent of the then counsel for Fidelity in Wisconsin?

A. I did not receive any notice to that effect.

Q. You have no information on that point?

A. No.

Q. Mr. Smith, are you aware that in the states of Wisconsin and Ohio and in, perhaps, some other states, the Attorney General's office is acting as counsel in the proceedings instituted in those states, without any fee being charged against those liquidations?

A. I know that is true, yes.

Q. Would that have a bearing on your answer to the question Mr. Fleming asked you as to whether you could liquidate more economically here?

A. I don't believe I answered Mr. Fleming direct, and I cannot answer the question direct now.

Mr. Reinhardt: I would like to follow up that line of inquiry, if the Court please.

Q. Are you familiar with the situation in the various states in which there have been receiverships?

A. Familiar in what regard?

[fol. 719] Q. That is, with relation to representation of the receivers and of the state officials interested in this situation by the Attorney Generals' offices in the respective states.

A. Yes, I am familiar with it.

Q. Will you tell us in how many of the states, in which such receiverships were pending, attorneys other than those in the office of the Attorney General of such states were representing the receiver or the state depository, or any other official in such proceeding?

A. The State of Pennsylvania had two sets of receivers; two in the eastern district and two in the western. The question you asked, as I understand you, is this: Do I know the states wherein the state officials did not bring the action and the Attorney General did not represent the state; is that right?

Q. No, wherein the Attorney General of the state did not represent either the state official or the state receiver.

A. They did not in Pennsylvania. I don't believe I could get that without referring to the files, and I am not sure we would be able to determine it from the files.

Q. You don't know as to that situation?

[fol. 720] A. No, I wouldn't be in position to say.

The Court: Would not that appear in some measure from the records we have here of appearances in this particular hearing and otherwise in this suit?

Mr. Reinhardt: It would appear in some measure, your Honor. The reason I asked this question was I understood he had answered Mr. Lauritzen's question on the basis of this type of information. Now, if I am correct in that understanding, then his answer to Mr. Lauritzen's question, on the basis of his present answer should be stricken out.

The Court: About the cooperation and so forth?

Mr. Reinhardt: No, Mr. Lauritzen asked him whether he didn't know that in all these states the receiver and other state officials were represented by the Attorney General of the state.

The Court: He has asked him with respect to Wisconsin only.

The Witness: I did not answer the question with the understanding that it was all of them, but I answered the question in that where the Attorney General did represent the receivers there were no fees paid in such states. I did not mean to answer it that the Attorney General represented them in all states, but just in those states where [fol. 721] the Attorney General did represent them that was the case.

Mr. Reinhardt:

Q. Even in those states where, to your knowledge, if there are such states, the Attorney General was acting in that capacity, do you know whether the Attorney General in such case was acting without compensation other than his official compensation as Attorney General?

A. Oh, I cannot say I actually know, because I don't know the statutes in that state.

Q. Now, with respect to the sales of securities of Fidelity by Wisconsin, Mr. Lauritzen asked whether you knew that was done with the consent of the attorney for Fidelity. I would like to ask you whether that was done also with the consent of the receivers of the State Court of West Virginia.

The Court: He said a while ago it was not. He said they protested.

Mr. Reinhardt:

Q. That is a fact?

A. Yes, we protested to the appointment of a liquidator.

By Mr. Lauritzen:

Q. Just a moment, Mr. Smith, are you aware that Mr. Robert Reeser of Madison, Wisconsin, who has been attorney for Fidelity for some years, was also purporting to act [fol. 722] out there as counsel for the West Virginia receivers in Wisconsin?

A. Yes.

Q. And he was your counsel?

A. Oh, he was acting rather—well, he worked with our counsel, probably at their request.

Q. Well, he was of counsel for the receivers, as well as for the Fidelity as a corporation, was he not?

A. You mean prior to the receivership?

Q. After the West Virginia receivership, did not Mr. Robert Reeser act in Wisconsin as counsel for the West Virginia receivers?

A. I think he worked in conjunction with our counsel.

Q. Such as Mr. Goldsmith of Koontz & Koontz, who came out at one time?

A. Yes, sir.

Q. And are not you aware that Mr. Reeser, as counsel for those receivers, consented to the sale of the securities on deposit in Wisconsin?

A. That could be, but I have nothing in my files and received no such notice of that.

Q. Mr. Reeser did not tell you what he had consented to in that regard; is that right?

[fol. 723] A. It could have been agreed upon by the counsel for the receivers; but I am speaking from my personal knowledge, that I didn't know it was done.

Q. You don't know one way or the other?

A. No, I didn't know it was done.

By Mr. Reinhardt:

Q. Speaking from your own personal knowledge, as to what you did, Mr. Smith, did you authorize or participate in authorizing Mr. Reeser to consent, on behalf of yourself as a co-receiver or on behalf of the other co-receivers, to the sale of these securities in Wisconsin?

A. No, I did not participate in authorizing the consent to that.

Q. In so far as the securities of Fidelity, which were deposited with state depositories, are concerned, was there any discussion as to cooperation between yourself, as one of the receivers in West Virginia, and the receivers appointed in the other jurisdictions for Fidelity?

A. I don't understand.

Q. Well, it is a pretty long question. I want to know whether you talked to any of these other receivers in these other jurisdictions about what you would like them [fol. 724] to do with the securities that had been deposited by Fidelity with the state depositories in that jurisdiction.

A. The receivers I talked to, I told them I hoped they would leave the securities undisturbed until such time as the West Virginia receivers had an opportunity to work out a plan and go over it with them; that we certainly did not want the assets disturbed or sold.

Q. And what was their reaction to that suggestion?

A. The only adverse reaction to that suggestion I can point to was in the State of Wisconsin, where they did proceed to liquidate some of the securities.

The Court:

Q. Did you get any agreements out of any of the other receivers to hold things in status quo?

A. No, your Honor, I have no knowledge of any agreements. I do have knowledge of—I believe Mr. Lloyd of Ohio said they would just stand by. I hope I am not misquoting him; that they would stand by and see what developed over in the West Virginia receivership.

Q. Other than that, was there any one who made any positive commitments.

A. That they would wait?

Q. Yes.

[fol. 725] A. I don't recall that there was.

Mr. Reinhardt:

Q. Did you have contact with receivers or officials in all the states in which Fidelity had deposited securities?

A. No; I may have had correspondence, but no personal contact with all of them.

Q. Without going into too much details, will you indicate to us the states in which you had contact with the re-

ceivers or similar official, and what their attitude was in each case?

A. Well, in Ohio Mr. Lloyd, Ancillary Receiver of Ohio, was receiver for the assets in Ohio other than the state deposits, was my understanding, came over and talked to us.

Q. Let me interrupt you a minute. You referred to Mr. Lloyd as ancillary receiver.

A. Yes, I think the order of his appointment by the Ohio state court made him an ancillary receiver for the assets other than the securities on deposit.

Q. What did those assets amount to?

A. Not very much; some branch office furniture around through the State, small bank balances, not amounting to more than ten or twelve thousand dollars, as a guess.

[fol. 726] Q. How did that compare with the deposited securities, for example?

A. Oh, it is insignificant compared to the deposits, of course. The deposits were around—it is in the record—half a million dollars, as I recall.

Q. What was the situation as to the significant portion of the assets in Ohio, the deposited securities?

A. That is what I say, it was around half a million dollars.

Q. Did you have any discussion which indicated that those would be held in accordance with your wishes, or disposed of in accordange with your wishes?

A. No.

Q. What other states?

A. The receivers for the western district of Pennsylvania came down just to see us. They had no assets. I think the assets had been seived by the receivers in the eastern district, that is, the deposited securities which they had. I think in their district there was some furniture in the branch offices in Pittsburgh, Uniontown and so on; nothing, however, came from that other than they said they wanted to go along and help us, and so on.

Q. They had very little to help you with.

[fol. 727] A. They were going to attempt, I don't know how far they got with it, to get their share of the assets on deposit.

Q. That is from the eastern district?

A. The portion that belonged over in that district.

Q. You mean the receivers in the western district of Pennsylvania were going to try to get from the receivers

in the eastern district of Pennsylvania a part of what the receivers in the eastern district of Pennsylvania had?

A. That is right.

Q. And once they got that, they would be in position to cooperate with you?

A. Yes.

Q. And they expressed a willingness to do that if they got it?

A. They most certainly did.

Q. What else?

A. I don't know—well, we talked with the state officials from Indiana. They came over prior to the appointment of the receiver and I remember asking them particularly if they would not have a receiver appointed over there to protect the assets, and they said they would, and as a [fol. 728] result of the conference over here they went back and the proper steps were taken for the appointment of a receiver.

Q. What else?

A. That is all I recall.

Q. How about Missouri? Did you talk with them or they to you?

A. Yes, they came over here. First, the Attorney General—I believe the Secretary of State has charge of securities in Missouri, and I think the Securities Commissioner—anyway, a receiver was appointed who came over and wanted us to send the securities here on deposit in West Virginia to the State of Missouri. I mean, they are held in the Wheeling bank for the State of Missouri, and they wanted us to agree right off to let him have those securities to ship back to Missouri, and of course nothing came of that. We did not agree.

Q. He was willing to cooperate with you to the extent of having you direct the Wheeling bank transfer the securities from Wheeling to Missouri?

Mr. Schurr: I object to the form of that question as very improper.

Mr. Reinhardt: I will withdraw the question.

[fol. 729] Q. As to these assets in Ohio, which you describe as the insignificant portion, do you know whether they are still in the possession of the Ohio receivers?

A. Yes; such assets as Ohio receivers had were turned over to Mr. Bolden, an employee of the Trustee, just a few days ago.

Q. And are now held by the Trustee as part of this estate?

A. That is right. That is, they turned over the cash they had in their hands, and then the rest of it, certain office furniture, was shipped to Wheeling.

Q. Did you have any contact with the receivers in Illinois?

A. No, I did not.

Mr. Reinhardt: If the Court please, Mr. Huwe has handed me a question. I don't quite get what he has in mind, so I will ask that he be allowed to ask the witness.

The Court: All right.

Mr. Huwe:

Q. Are you aware that, in spite of the cooperation with Mr. Lloyd of Ohio, with reference to leaving out of the receivership proceedings the deposits, that in spite of that fact, a creditor filed an answering cross petition in the re-
[fol. 730] ceivership suit, seeking to bring into that suit the deposits and liquidate them, and that the same creditor laid the foundation by correspondence for a mandamus suit to also liquidate those assets; so, even though Mr. Lloyd cooperated to an extent, he was practically faced with a situation where he could not further cooperate, because of a creditor's activities.

A. No, I don't know a thing about that.

By Mr. Palmer:

Q. Is it not true that after the receivership suit brought in the Circuit Court of Kanawha County, the Auditor of West Virginia notified the various states which were interested in Fidelity and had deposits there, and that they did take proper steps, the officials of those states, to institute court proceedings to carry on or take charge of the matter in their state.

A. As I said, I have knowledge of Mr. Sims' telegram asking for the appointment of receivers to protect the assets in the respective states where they were deposited. A good many states did. I think I am right, in fact I know some states did not appoint receivers, but a good many did.

Q. Were there any states which had deposits in them
[fol. 731] which did not appoint receivers?

A. To my knowledge, I don't believe the State of Maryland did. I could be wrong, just speaking from memory, but I don't believe they did in Alabama, either. They did in most of the states.

By Mr. Farmer:

Q. Mr. Smith, is it not true that to this date not a single state, which was holding deposits for the protection of its contract holders on the day of the filing of this petition, June 6th, has complied with this summary turnover order and delivered the deposits to the Trustee?

A. To my knowledge, the only assets turned over to the Trustee was in compliance of the order of this Court directing the West Virginia receivers to turn over, which we did.

Q. I say, no deposit has been surrendered to the Trustee?

A. To my knowledge, no.

Q. Did you attend this meeting in this court room, an informal meeting on July 9th, which was attended by the Securities Commissioners or the assistant and representatives of the legal departments of some ten or twelve states, discussing this turn-over order?

[fol. 732] A. No, I am sorry I was not here. I wish I had been.

Q. Have you found out this to be true from your knowledge of the business since you have been connected with the Trustee, and the communications you have had, that the invariable uniform attitude of these states is that they will not comply with this turn-over order and they will hold on to these deposits, regardless of what happens in this proceeding; that they will just let the Trustee come out there and see if he can get them on their own home ground?

The Court: What do you mean by that question? Are you trying to convict all these people of contempt of the Federal Court?

Mr. Farmer: I am trying to show that this proceeding—the attempt to reorganize the debtor in this proceeding, a Chapter 10 proceeding, and the summary turnover order that has been made, has created a friction or an uncertainty and disinclination on the part of the state officials having jurisdiction in these various states, to turn over these deposits, and that, without the hearty cooperation of the Se-

curities Commissioners or officials, whatever their titles may be, in these various states in which this company, if [fol. 733] reorganized, would do business, that there is no reasonable prospect of reorganization; and further, that the situation is such that, in view of the doubt of the power and the jurisdiction of this Court by a summary order to compel turn-over of these deposits, that it could only be ascertained at the end of protracted and expensive litigation, whether such power existed or not in this Court, and that in a company of this kind, the success of which is dependent upon the uninterrupted continuity of these payments and the good will of these contract holders, that all of that can be dissipated and lost before any plan of reorganization could be confirmed after all of these legal questions were determined.

The Court: I don't think the question of the Court's power or lack of power to direct the turn-over of those assets has anything to do with the feasibility of the plan.

Mr. Palmer: I think it would be proper to ask, is it not true that the states have resisted the Trustee's collection of them, in a proper legal manner, and have properly and legally raised questions before the Court as to the propriety of the order, indicating that the states are resisting the [fols. 734-735] order through legal processes, rather than agreeing to the plan voluntarily.

The Court: That appears from the pleadings filed. There is no use asking about that.

Mr. Reinhardt:

Q. Mr. Smith, do you know whether the appointment of receivers in states other than West Virginia was made in compliance with the telegram that Mr. Sims sent requesting that such receivers be appointed?

A. I think most of them were.

Q. Do you know? In other words, my question is this: Do you know whether the appointment of those receivers was in compliance by the person who received the telegram with the request contained in the telegram?

A. I think a good many of them were; as to how many, I don't know.

. . . . . .

[fol. 736] Mr. Jaegerman:

Q. Do you know that the Investors Syndicate of America is a face amount certificate company, and has registered

under the Investment Company Act of 1940, and is selling in West Virginia and other states?

Mr. Lauritzen: I object. In the first place, it is apparently a matter of official record with the SEC and could not be the best evidence by quite a far degree.

Mr. Palmer: Let me ask Mr. Jaegerman: Isn't it a fact that they have a new company formed for the purpose of complying with this act, and has most of the structure and body of the old Investors Syndicate Company?

[fols. 737-738] Mr. Jaegerman: I don't see where it is material.

The Court: I don't either. We may form a new company out of Fidelity before we are through with it; and as to Mr. Lauritzen's objection, it is overruled. (Exception.)

Mr. Lauritzen: Further, your Honor, it is a conclusion of law as to whether any company is qualified, because whether you are qualified or not would depend upon an examination of the law, and upon an examination of the papers they filed, and this witness could not possibly answer that.

The Court: Overruled. (Exception.)

Mr. Jaegerman:

Q. Mr. Smith, do you know whether the Investors Syndicate of America is selling fact amount certificates today?

A. I have not had occasion to see one of these certificates being sold. They were sold in 1941.

* * * * * * *

[fol. 739] F. H. Pulfer, having been first duly sworn as a witness, testified as follows:

Direct examination.

By Mr. Fleming:

Q. Give the Court your name, please.

A. F. H. Pulfer.

Q. Where do you live, Mr. Pulfer?

A. 1197 Chatfield Road, Winnetka, Illinois.

Q. Mr. Pulfer, what has been your physical condition, now, for several weeks?

A. Well, I have been quite ill. For the last two and a half years, as a matter of fact, I have been ill.

Q. Has that been a heart difficulty?

A. Yes, sir.

Q. Did there come a time when you entered the employment of Fidelity Investment Association?

A. Yes.

[fol. 740] Q. When was that?

A. I actually entered the employment of the Fidelity actively March 1, 1924.

Q. How long did that employment continue?

A. Until I received a letter from the receivers discontinuing my services.

Q. About when was that?

A. The letter was dated April 25th, effective April 15th, of this year.

Q. 1941?

A. Yes.

Q. In what department of Fidelity were you first employed?

A. As a salesman.

Q. Where?

A. Chicago.

Q. What had been your previous employment, Mr. Pulfer?

A. I had been in the corset manufacturing business.

Q. In Chicago?

A. No, in Kalamazoo, Michigan.

Mr. Palmer: Was Mr. Pulfer employed by National Sales Agency?

[fol. 741] Mr. Fleming: Let me alone, please, until I get the entire complete history of this, and I will appreciate it very much. I don't want to be impatient, but I will get to that directly.

Q. Mr. Pulfer, had you been in the corset manufacturing business very long?

A. Three years.

Q. And what department of that had you particularly to do with?

A. Sales.

Q. What had been your employment prior to that time?

A. I was with the F. E. Compton Company in the book publishing business.

Q. And where were you situated or located?

A. I was located from 1917 until 1922 in Chicago, at

their home office. Prior to that time I was all over the United States for them, selling books.

Q. While you were in the home office of that company, what department were you in?

A. I was vice president of the company, in charge of their recruiting and building up of their sales organization and sales.

Q. The training of their salesmen, you mean?

[fol. 742] A. Training salesmen, yes.

Q. And you were in that employment about how long altogether?

A. Of course, I worked my way through college selling books, so I was in their employ, I would say, from 1911 through 1921, January 1, 1922.

Q. You went through college, I understand, at Indiana University?

A. Yes, Indiana University.

Q. And when did you graduate?

A. 1916.

Q. And then you continued with the Compton Company?

A. Yes.

Q. What was their business generally?

A. Well, they published at that time the New Student Reference Work, but later it became Compton's Picture Encyclopedia, a very fine set of books for children.

Q. After entering the employment of Fidelity in 1924, what was your work at the beginning?

A. I started selling the Special Income Contracts.

Q. In the field?

A. Yes, in the field; on the streets selling it.

Q. How long did you continue that?

[fol. 743] A. Until 1926.

Q. And with what success?

A. Well, with better success financially than I had had in the corset business.

Q. You had not gotten along so well in the corset business?

A. No, the ladies had decided to quit wearing corsets at that time, so business was not so good.

Q. After you quit selling these contracts, as you said, on the streets or from house to house or person to person, what phase of the employment did you enter for Fidelity?

A. Well, I went to Michigan and opened the State of Michigan for Fidelity, and established an office there in

Detroit, and later at Saginaw and Flint and Grand Rapids and other points in the State, and continued my selling and, at the same time, I began hiring and training sales representatives in that territory.

Q. How long did that continue?

A. I was there until June, 1927.

Q. And then where did you go?

A. At the request of the home office, of Fidelity, they asked me to go back to Chicago and take charge of the sales [fols. 744-748] there, which I did.

Q. How long did you remain there?

A. I am still there.

Q. You have been there ever since, working for Fidelity?

A. Yes, sir.

. . . . . .

[fol. 749] Q. Who was the National Sales Agency?

A. The National Sales Agency was Mr. Fred King and Mr. A. L. King, I believe.

Q. Was it a corporation?

A. I believe it was.

Q. And the stock was handled or held by the two Kings, A. L. and Fred?

A. Yes.

Q. What about the other corporation or agency you mentioned?

[fols. 750-751] A. I think it was a partnership.

Q. Did you know those partners?

A. Yes, they were the gentlemen I went to work for originally.

Q. How long did they work for the Fidelity?

A. I don't believe I could tell you when they started, but the partnership, I believe, was dissolved and they both retired from this type of business in 1924.

Q. Then how was their territory handled?

A. No, I will correct that. I believe it was in 1925 that they retired from business. Then the National Sales Agency took over that territory.

Q. How long did National Sales Agency handle sales for Fidelity?

A. I believe it was in 1933 that they ceased to handle any of the sales work for Fidelity.

. . . . . .

[fols. 752-755] Q. After 1933, and after National Sales Agency had ceased handling sales for Fidelity, then what happened to the sales organization of Fidelity?

A. Well, the sales organization then worked for what was termed the agency division of Fidelity Investment Association.

* * * * * * *

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[fol. 756] H. Isaiah Smith, was thereupon recalled for further examination, and testified as follows:

By Mr. Jaegerman:

Q. Mr. Smith, when you were last on the stand you were requested to furnish this Court with a break-down of the cash surrender liability and other contract liabilities by funds and by series, and further broken down by geographical distribution; in other words, by states. Do you have [fol. 757] that information available now?

A. Yes, I have secured it.

Q. I show you a chart, entitled "Fidelity Assurance Association Geographical Distribution of Number and Face Amounts Required Reserve Cash Liability and Contracts Loans on Contracts in Force April 10, 1941" and ask you to identify it.

A. That is correct.

Q. Does this chart show the liability in every state in which contract holders reside, regardless of whether or not the contracts were sold in those states?

A. That is right.

Mr. Jaegerman: Your Honor, we offer this chart in evidence as Exhibit No. 34.

The Court: It may be received.

Exhibit No. 34 Filed

Mr. Lauritzen: Did you have him identify it further as to who compiled it and the source of it, and his connection with it? I did not understand that that has been done.

Mr. Jaegerman:

Q. Mr. Smith, was this exhibit prepared after you became a State Court receiver?

A. Yes.

[fol. 758] Q. Was it prepared at your direction?

A. It was; that is, the joint direction of the two receivers.

Q. You and Mr. Thomas?

A. That is right.

Q. It was prepared by the staff of Fidelity Assurance Association?

A. That is right.

Q. From the books and records of Fidelity?

A. That is right.

Q. After this was compiled by the staff, was it submitted to you in your official capacity as co-receiver?

A. It was.

Q. This Exhibit 34 shows not only the number of contracts outstanding in each state, but the face amounts of those contracts?

A. That is right.

Q. Required reserves?

A. That is right.

Q. The gross cash liability?

A. Right.

Q. The contract loans and accrued interest?

A. Right.

[fol. 759] Q. And the net cash liability?

A. Right.

Q. This shows the Income contract fund, the Annuity Contract fund, the Series A Contract fund, the Series B Contract fund, the Series C contract fund, and the Series D Contract fund?

A. Right.

Q. Each separately?

A. That is right.

Q. Then there is a total column?

A. A general summary.

Q. Being the number of contracts and the face amount?

A. Right.

Q. Is not this fund divided by the active contract fund and the maturity and retirement reserve fund, where such separate funds are maintained for any one series?

A. It is.

Mr. Farmer: May we see that? I don't know whether we will object to it or not.

Mr. Jaegerman: Certainly (handing exhibit to counsel). Is there any objection on the part of any attorney to this exhibit?

Mr. Farmer: No, sir, it appears to be what we have been [fol. 760] calling for for about three days.

Mr. Jaegerman: I am sorry Mr. Huwe is not here. He has just stepped out, I suppose. He is the man who made the request this morning for this exhibit.

Your Honor, I have no further questions on this exhibit.

The Court: Is there any cross-examination with reference to the exhibit?

Mr. Farmer: Your Honor, we may want to ask some questions later. This is quite a voluminous calculation, and it is impossible in a few minutes to examine it and say. I don't think so, but it is hard to say right now whether we will want to ask any questions about it or not.

The Court: All right. Is there anything further with this witness?

Mr. Reinhardt: Yes, your Honor, I would like to ask a few questions.

By Mr. Reinhardt:

Q. Mr. Smith, you are familiar with the assets of this debtor as of June 6, 1941, are you not?

A. Familiar with the record of the assets, yes.

Q. Now, will you tell us the following facts about those assets: the nature of them and as to each asset, whether [fol. 761] it was located in Charleston on June 6, 1941, whether it was located in Wisconsin, Illinois, or any other place outside of Charleston on June 6, 1941, and the market value on June 6, 1941?

The Court: Why not also include in that whether located in any other place in West Virginia besides the southern district?

Mr. Reinhardt: That would be included, your Honor, among all others.

The Court: I would like to find out where all the assets were. You said in Charleston or other states.

Mr. Reinhardt: This will cover all the assets. What I have asked for is that all the assets be broken down into the following groups: those in Charleston or within the jurisdiction of the southern district of West Virginia, and the assets which are located anywhere else than in this jurisdiction. I understand that the witness has broken that second group down into Wisconsin, Illinois and any other place simply because those two jurisdictions mentioned happen to have the largest single aggregation of assets of this debtor as of that time.

The Court: All right; go ahead, Mr. Smith.

A. The assets as of June 6, 1941, as shown by the records [fol. 762] of the company, are comprised of securities—I will not attempt to classify those, that is, stocks, bonds and so forth, real estate and mortgages on real estate, and cash, and loans to contract holders; that is, loans secured by the contract owner's contract itself. Then furniture and fixtures and an equity in a life insurance policy carried on a former employee, a former person who performed services for the company, and loans to Fidel bond holders, and accrued interest on bonds and mortgages and so forth; then, of course, you have that little odds and ends of small items that we usually classify for bookkeeping purposes under "Miscellaneous Assets".

The market value of the securities as of June 6, 1941, located in Charleston, that is, on deposit with the State of West Virginia, amounted to $9,592,128.83; mortgages, the book value of those mortgages, and that consisted of the home office—for instance, in this total assets, in the balance sheet, the home office is carried, that is, the deed to the property or title for the property being vested in the association and carried at a book value; then, in turn, a mortgage was placed on the home office which is owned by the two contract [fol. 763] funds, or two of the reserve funds, so if you total up the total assets, as shown by the balance sheet, you would be carrying the same piece of property twice as an asset; so that was, of course, something that could not exist, that is, you could not count the home office building as an asset in the general fund and then count the mortgage on it up to the full amount of its book value as an asset in another fund. The book value of the assets, therefore, the mortgages on deposit with the State of West Virginia, have a

book value of $1,082,567.25. There was cash which had been transferred by the receivers to the banks in the City of Charleston on May 23rd, $250,000; and then cash, in the amount of $111,019.05, transferred to the banks in the City of Charleston, which were funds segregated under the order of the Court; the accrued interest on bonds and the accrued interest on mortgages, on the securities and mortgages on deposit with the State of West Virginia in Charleston amounted to $171,504.58, making a total of $11,207,219.71.

On June 6, 1941, as shown by the records in the office in Wheeling, the market value of securities on deposit in the State of Wisconsin was $2,619,399.07; the accrued interest on these securities amounted to $17,150.46, making a total [fol. 764] asset as shown by the records in the office of $2,636.549.53 in the State of Wisconsin.

On June 6, 1941, in the State of Illinois, the market value of securities on deposit, as shown by the records in the office, was $3,759,894.00; and the accrued interest on these securities, as shown by the books, was $42,876.14, making a total of $3,802,770.14.

All other assets, located as shown by the records in the office, the market value of securities was $3,350,482.69; the real estate book value was $438,105.11; mortgages, book value, $208,675.94; cash on hand and in bank, $347,324.08; cash deposited under the order of the Court by the receivers, to be held at the direction of the Court, was $169,597.65. Loans on contracts, secured by the——

Mr. Reinhardt:

Q. Just a minute. Let me ask you this: contract loans have no physical location, is that right?

A. That is to be determined by this explanation, that these contract owners probably scattered all over the country would borrow money on their contracts and execute a loan agreement, which is carried as an asset on the company's books. As to where it might be located, the physical contract and the contract agreement by the contract owner [fol. 765] of course, is located in the home office. That figure is $1,459,271.07.

The book value of furniture and fixtures is $79,694.74. The life insurance policy, the cash surrender value less a loan, the net equity in the value of this insurance policy is $2,994.24. The loan to Fidel bondholders, $156,406.52, and

accrued interest on bonds, mortgages, and so forth, $111,477.99; miscellaneous assets, $21,483.75, making a total of assets located in other than the three categories named heretofore, $6,345,513.78, making a grand total of assets, as shown by this report, $23,992,053.16.

Q. Now, of these assets, contract loans of $1,459,271.07, life insurance policy of $2,994.24 and loan to Fidel bond holders $156,406.52 are the type of thing that has no physical location; is that right? I mean, there is nothing you could point to that is that thing, or any of those things?

A. No, it is really—well, the loans for instance, to contract holders is really a method of bookkeeping, but it is a lien on the contract holder's cash value on his contract.

The Court: In effect, it simply reduces the liability, rather than builds up the assets?

[fol. 766] A. That is right.

Q. But as it is handled the liability is left on the books and the asset is placed to offset it.

A. That is right.

Mr. Reinhardt:

Q. When a loan is made to a contract holder, does he sign a note for that loan?

A. He signs a loan agreement, which is the same thing as a note, I would say.

Q. Where were those loan agreements located on June 6, 1941?

A. In the home office.

Q. In Wheeling?

A. That is right.

Q. Is the same thing true as to loans to Fidel bondholders?

A. No; I hope I won't make it complicated, but under the indenture of Fidel, a wholly owned subsidiary of Fidelity, the Fidel bond, itself, did not agree to loan the bondholder any money at all on its contract, but in the indenture the parent company of Fidel, or Fidelity, agreed to make these loans. The mechanics, briefly, are these: the bondholder would send his bond, with a loan agreement, to Fidelity. Fidelity would make the loan. Fidelity would, [fol. 767] in turn, execute its note and secure that note with the contract owner's loan agreement and his contract, and

forward it to the Trustee for Fidel, who in turn would buy that, one of the reserve funds, and Fidelity would get the money back.

Q. The Trustee for Fidel, to whom this stuff was sent by Fidelity, was located where on June 6, 1941?

A. The Colonial Trust Company, New York City.

Q. Is that where these documents were at that time?

A. That is right.

Q. On June 6, 1941?

A. That is right.

The Court: Let me ask this question: I did not notice whether Mr. Smith gave a total of the market value of assets situated out of the southern district of West Virginia, or not. He gave the total of $11,207,000 assets situated in this district, but not the total outside.

Mr. Reinhardt: I don't believe he did, your Honor. In doing that, may I suggest that Mr. Smith eliminate contract loans, life insurance and loans to Fidel bondholders, because there may be some question as to where those were located, because of their nature.

[fols. 768-772] The Court: They can be tabulated separately. Yes. Also, you gave the answer in two separate items; one, the total of the items just mentioned by Mr. Reinhardt, and the other, all other assets.

A. The assets, according to this schedule on June 6, 1941, in Charleston, amounted to $11,207,219.71; assets located outside of the City of Charleston, $12,784,833.45.

Q. Including contracts and so forth, or excluding?

A. Including. Now, if we exclude the loans to contract holders, the value of the life insurance policy and the loan to Fidel bond-holders—I repeat, by excluding contract loans, cash surrender value of the life insurance, loans to Fidel bond-holders, the assets located in places other than Charleston would be $11,166,161.62.

Mr. Reinhardt:

Q. What is the total of those three items you have excluded?

A. $1,618,671.83.

Mr. Reinhardt: That is all, your Honor.

* * * * * * *

[fol. 773] Q. In the course of your business career, have [fols. 774-778] you ever occupied a position which called upon you to form opinions as to the value of real estate?

A. Yes, when I was a Bank Commissioner I would have to pass on values of real estate.

Q. I thought you testified you were a State Budget Director once?

A. That is right.

* * * * * * *

F. H. Pulfer—Direct.

[fol. 779] Q. Tell the Court, if you will, what occurred at that meeting.

A. Every director was present except Mr. Burt, and Mr. Risley, and the only thing that Mr. McNulty was there for—he was not a director, but he was secretary of the company, and there was some discussion about his possibly being embarrassed by being present there, since he was working for the receivers, and he thought that he would be if he attended the meeting, so he resigned as secretary and left the meeting. Mr. King was elected secretary, to take the minutes of the meeting.

The discussion was largely a matter of what was the best thing to do under the circumstances. The feeling was that it would be best to bring this matter into a Federal [fols. 780-783] Court. The resolution was passed to that effect.

Q. What about the situation of the company at that time as to being in receivership and state receivers being appointed and so forth?

A. Well, of course, in the matter of reorganization we all seemed to think that it would be very difficult to attempt to do that with so many receivers in so many states, and that until this was brought into one jurisdiction, where you could deal with one court, why, you would be up against a very difficult job in even attempting to effect any reorganization plan.

* * * * * * *

[fol. 784] Q. Explain, if you will, briefly the character of people who bought these contracts in your territory, and whether or not the rate of interest was a controlling factor;

just explain generally your methods and the policy of selling these contracts.

A. Well, of my own personal opinion, I don't think that the rate of interest ever had much to do with the sale of a Fidelity contract.

Q. Explain that to the Court, please.

A. I don't think people bought these contracts because they were going to receive any special rate of interest. We sold these contracts based on its being a compulsory savings plan; in other words, to get a man to do something he otherwise would not do. I had not been in this business but thirty days until I learned that was the principal appeal, that this particular thing carried. In other words, and for example, the matter of saving money is a difficult thing for the average person to do, and most of them will not do it [fol. 785] unless they are urged or impelled to do it some way or other. Now, this plan offered that urge; it offered that element of compulsion which would get a man to do that particular thing, which otherwise he probably would not do, and I don't believe that the terms of the contract, in so far as interest was concerned, had very much to do with it. Certainly we did not sell it based on that.

Q. Now, to what class of persons did you sell contracts?

A. Well, of course we sold contracts to pretty near all classes of people.

Q. Explain that briefly.

A. We have some of the outstanding business men, bankers, professional men of the different communities who use these plans for savings, and have done so far years. I can name many of them: William Wrigley, Warren Wright—and I might say, when he concluded his plan with us, he wrote us a letter and said he had never missed the money that he had saved; that it was like walking out in the street and finding it.

Q. Who is Warren Wright?

A. At that time he was president of Calumet Baking [fol. 786] Company. He was better known later because he owns Whirlaway, the horse of the year.

However, we have sold many men of that type; bankers of Chicago and Detroit, who have admitted to me that they had better success in saving money under this plan, than in their own banks, because they would not do it in their own banks.

Q. What about the future of Fidelity in so far as the continued use of this plan is concerned, Mr. Pulfer?

A. Well, of course, I think there is just as big, if not bigger, fields today than ever.

Q. For compulsory savings?

A. Yes, sir.

Q. Irrespective of the rate of interest?

A. Yes, sir.

Q. Except that the company cannot agree to pay a larger rate of interest than they can afford to pay under present conditions.

A. Yes, but I don't think that makes any difference in selling.

Q. Have you heard of the Investors Syndicate?

A. Yes, sir.

Q. What business are they engaged in?

[fol. 787] A. Very similar or practically the same, except as to the terms of the contract, and other details.

Q. Are they still engaged in business?

A. I understand they are.

Q. And successfully?

A. I understand they had a very nice business last year.

Q. And had a large appreciation in assets?

A. I was told in Chicago they had an increase——

Mr. Palmer: I object to what he was told in Chicago about their business. I am afraid that would be heresay.

Mr. Farmer: I object to counsel leading the witness also.

The Court: I am going to let him testify as to that. Overruled. (Exception.)

A. I will amend it by saying I was told by a member of their organization that the increase in assets was over ten million dollars.

Mr. Palmer: I object, and move to strike that out.

The Court: Overruled. (Exception.)

Mr. Fleming:

Q. Do you know how widespread their activities are?

A. No, I don't believe I can answer that.

[fol. 788] Q. Do you know the aggregate, or approximately the aggregate amount of their assets today; that is, the Investors Syndicate?

A. No, I don't believe I can answer that.

Q. In your opinion, do you think it is feasible to develop a plan of reorganization in this proceeding and rehabilitate the affairs of Fidelity?

A. I think so.

Q. Explain that, if you will.

A. Well, of course, after spending over seventeen years in this business, and after seeing the results that this plan has given to many hundreds and thousands of people, I think it performed a great service and, with the number of people that are using the plan, with the soundness of the plan properly revised to meet present day conditions, I think it would have just as as great an appeal today, or greater, than it had in the past, because many things have happened in this country in the last few years that, in my opinion, make people more savings-minded than ever before. There is an editorial in the local paper, I believe, this morning as to Secretary Morgenthau making a statement with reference to compulsory savings. The activities of the Government in assisting people to save are many, and is [fols. 789-793] proving a helpful thing. All those things contribute, in my opinion, and did contribute to making the plan successful and making this business more successful and better than ever. I don't regard those as competition.

Q. In other words, a well managed company, pursuing, or at least partially pursuing the savings plan followed by Fidelity could succeed financially, in your opinion?

A. I think so if properly handled, and they don't promise too much.

* * * * * * *

[fol. 794] Q. Was there some sort of merger or refinancing plan that Mr. Messick and Mr. Rosset had been interested in developing for the company prior to that time?

A. Well, I brought Mr. Messick into the picture; perhaps I had better explain that.

Q. I wish you would.

A. There had been a great deal of talk about the need of additional capital for the company. One of the officers and directors of the company had taken it upon himself to raise capital for the company. He had been unsuccessful in doing so. I told them then, in Wheeling, that I thought some people in Chicago might be interested in coming into this Fidelity picture, and perhaps provide whatever capital was necessary.

One year after I told them that, they told me I might proceed to talk to those people. I saw that the need was for more than capital, and I felt the need was for management as well as capital.

Now, I had known Mr. Messick thirty years, at Indiana [fol. 795] University together, and so they were having a little group of Indiana University men at luncheon for Paul McNutt in Chicago, and Mr. Messick happened to be sitting at my table, and I talked to him about Fidelity. The next day he came to my office and I told him more about it. He had been very successful in his business career, had been a banker and a lawyer, and had had considerable experience in reorganizing matters, and I told him I wanted his help. He became interested in the picture.

It was through Mr. Messick that Mr. Rosset became interested. After they had studied the preliminary figures on Fidelity, and had gone over the many different factors entering into this Fidelity business, why, they jointly decided they, perhaps, could do something about it, and they presented a proposition to the company, to the board of directors of Fidelity, which the board passed on and which gave them the option or the opportunity to look further into the affairs of Fidelity, with a view to contributing capital and management. That was never consummated because the company could not qualify under the terms of the agreement.

Q. Explain that, if you will.

[fol. 796] A. There were several things about that, that did not seem to work out. One was the deposit of the common and preferred stock with the Trustee in a given percentage. Another was that it was predicated upon the examination of the portfolio, and the assets of the company. That did not work out just as well as they thought it should. Then, I think the thing that caused the collapse of that program of Rosset and Messick was when Mr. Messick found the source from which money was coming.

Q. Through Mr. Rosset?

A. Through Mr. Rosset; it was coming from a man named Green in Chicago, who did not bear a very good reputation, and as soon as he told me about it, I said, "We don't want anybody like that in Fidelity," and our judgment was pretty well vindicated, because Mr. Green was later indicted for some kind of stock shuffling in connection with Esquire Publishing Company.

Q. That appeared in all the newspapers, I believe?

A. That is right. The minute his name was mentioned, I know that I felt we did not want anybody like that mixed up in that business, and the board of directors knew of that situation.

Q. The board of directors knew all about these circum- [fol. 797] stances and everything connected with this deal, and why the deal was not developed beyond the point where it was; is that right?

A. That is right.

Q. And knowing all that later Mr. Messick was elected chairman of the board of directors; is that right?

A. That is right.

Q. When was that?

A. I cannot tell you the date; I don't remember.

Q. Was that in August?

A. I think it was at a board meeting held in August.

Q. Was he present?

A. No.

Q. Were you present?

A. I was there.

Q. Who else was there?

A. I believe we had a full board meeting, the minutes would show.

Q. Was Mr. Marshall there?

A. I believe he was there; I don't remember. The minutes of the corporation will show who were present; I don't recall.

Q. Was a salary fixed for Mr. Messick; or do you recall [fols. 798-803] that?

A. It was fixed at $1,000 a month.

Q. And that was last August, 1940?

A. Yes.

Q. Did Mr. Messick accept his election as chairman of the board of directors of Fidelity?

A. He wrote a letter accepting it, and stating in the letter the terms under which he would accept it.

Q. Then if he became rather active in the management at that time, you may tell the Court about it.

A. Yes, he did.

Q. And where did he have his principal office?

A. In Chicago.

Q. His principal office was in Chicago?

A. Yes.

Q. I will ask you whether he gave practically all his time to Fidelity.

A. He gave all his time to Fidelity.

Mr. Palmer: I object, unless the witness was there personally.

Mr. Fleming:

Q. Were you there personally?

A. I know that he gave all his time to the affairs of the company before and after his election.

. . . . . .

[fol. 804] Mr. Fleming:

Q. Mr. Pulfer, do you think of anything else you would like to explain to the Court?

A. You asked whether the company should go on, or whether this type of business should go on. Of course you know some of the men who have been out in the field end of the Fidelity business have had a great many experiences that, perhaps, have never come to some of you gentlemen in the room here, in dealing with people who have matured their contracts, or people who have come into the offices under great stress, under great urgency, to cash surrender their contracts, or want to borrow money on them and get the maximum loan value.

After all, the reaction of people who have used the plan for a number of years gives you a pretty good measure of its worth and you have learned, from talking to these contract holders and hearing them express themselves, what they think about it, as being so thoroughly satisfied with the services of the company, that they are thoroughly [fol 805] sold on the idea.

Having seen a good many young men go off to college, who otherwise would never have gotten there; I think, if I may just use an illustration of one case, that it will show you what I mean. There was an old janitor for a large apartment house in Chicago, who came in the office and received his commuted value on a contract and shortly thereafter used the proceeds to take his wife and two children and a little old Ford car over to his native country of Rumania, where he spent some sixty days, traveling through that country of his boyhood, and he sent me postcards from all

over that area, "Having swell time. Would not be here if it was not for Fidelity," and things like that—they just occur all the time.

Mr. Farmer: I object to that line of testimony because it sheds no light on this question.

The Court: I don't see how that helps the Court, so we will not go any further along that line.

Mr. Fleming:

Q. The articles of incorporation of Fidelity were amended near the close of the year 1940, under the laws of the State of West Virginia. Are you acquainted with the reason or reasons for that, or do you know how that happened to be done?

[fol. 806] A. I think it was the concensus of opinion that we probably would have broadened our field of selling to include insurance.

Q. Along with the sale of——

A. Along with the sale of the type of plan we had been selling. Now, during this period from December 14, 1938, on, many of our sales representatives had found it necessary to supplement their work with Fidelity by doing some work with insurance companies, and the two are really closer together than you think, and in many cases where our sales representative would develop a client, why, he very often would be asked whether he could furnish insurance; so that I think it was just—well, the thought was that it would broaden our field to include that along with the type of business we have been doing.

Q. Was it your intention to abandon completely the business of selling annuities?

A. No, sir.

Q. Had you ever sold anything else?

A. No, sir.

Q. Did you ever sell any or issue any insurance policies?

A. No, sir.

[fol. 807] Q. You never operated under the additional powers granted by the amendment to this charter?

A. No, sir, we were never permitted to sell.

Mr. Fleming: That is all, your Honor.

The Court: Any cross-examination?

Mr. Palmer: Yes, your Honor.

Cross-examination.

By Mr. Palmer:

Q. Mr. Pulfer, what office did you hold with the company at the time of the suit in Detroit in 1938?

A. I was the Supervisor for the States of Illinois and Indiana.

Q. Now, at this meeting in Pittsburgh, Mr. Pulfer, was Mr. D. A. Burt a director, and was Mr. C. E. Smith also a director?

A. Both D. A. Burt—no, D. A. Burt was a director then.

Q. How about C. E. Smith?

A. No, he was not a director.

Q. After the Pittsburgh meeting you said it was the feeling there that the case should be brought into a court that had jurisdiction over all the states.

A. No, that was not what I said.

[fol. 808] Q. I am sorry; what was it?

A. I said I thought if the jurisdiction was within one court, that it would be easier to effect a reorganization than if it were necessary to deal with several courts.

Q. And you felt at that time, did you not, that all of the various assets should be gathered under one authority, under that one court?

A. No, not necessarily.

Q. That was not part of the feeling of the group?

A. No.

Q. Did you apply for, or were you granted any exemptions by the Securities and Exchange Commission to act as director or officer of the company after the suit in Detroit, and after the enactment of the Investment Company Act of 1940?

A. I don't recall that I did. I was not a director at that time.

Q. Your best recollection is, you were not granted any immunity; is that correct?

A. I don't recall that, or applying for any.

Q. Now, with reference to the money advanced you and other salesmen—I am not inquiring as to you individually, [fol. 809] Mr. Pulfer,—it is my understanding that during this suit in Detroit the company advanced moneys to you and other salesmen for your living expenses, or advanced the money for whatever purpose you cared to use it; is that correct?

A. Well, they sent money to us; whether they advanced it or not, I don't know.

Q. Did you say some of that had been written off the company's books as a loss?

A. My understanding is that has been done.

Q. Did you ever tell any of the prospective customers that advances or money was given to salesmen for work not done and commissions not earned?

A. No, sir.

Q. Did you know that in 1934, Edgar B. Sims, Auditor of the State of West Virginia, on October 12th of that year, wrote to the officers and directors of the Fidelity Investment Company at Wheeling, as follows:

"DEAR SIRS:

"I have had a conference with Mr. Weiss and Mr. A. L. King. Also on yesterday I had a conference with President Howard Sutherland of your institution. I find that these gentlemen still think it is all right to pay salesmen moneys in excess of the commissions on moneys actually collected and turned in to the company. And Mr. Sutherland [fol. 810] argues that there was no wrong perpetrated in the payments permitted by him of sums in excess of the commissions on moneys actually collected and turned in by the National Sales Company, and admits that there is a $66,000 increase in the advances to the Sales Agency. However, we find that there is an actual increase of $88,000 since the audit of January 1, 1933. Further, Mr. Sutherland argues that this is not stealing, and claims that it is only a matter of judgment.

"This office is unalterably opposed to his action and his contention. We hold that the taking of money from any source and paying it out before it is actually earned and collected constitutes the misuse of trust funds and is in plain terms 'embezzlement' or 'stealing' and would not bear the scrutiny of a Grand Jury.

"Therefore, we fell that the Board of Directors should take immediate steps to place somebody in charge of this institution who knows what stealing is when he sees it and is opposed to it.

"Yours truly, Edgar B. Sims, State Auditor and Insurance Commissioner."

Mr. Fleming: Your Honor, I object to that. This witness is not a director, or was not at that time, and I don't think this would throw any light on the issues involved here. I have no objection to the witness answering the question, but I feel that this line of cross-examination is outside of the issues in this case.

. . . . . .

[fol. 811] Mr. Palmer:

Q. Did you know that on September 19, 1934, Edgar B. Sims, wrote the following:

[fols. 812-815] "Charleston, W. Va., September 19, 1934.

"Private Rulings to the Officers of the Fidelity Investment Association, Wheeling, West Virginia

"1. No sums of money shall be advanced to any salesman, agent, agency or sales manager in excess of commissions actually earned and collected.

"2. If any salesman, agent or agency now owe the Association for advances made in excess of commissions earned and collected, a part of commissions as collected on any business must be applied on the debt owing from said salesman, agent or agency.

"3. If any salesman, agent or agency of the Association have advances against deferred commissions, such deferred commissions shall be applied when and if collected to the said advances against such deferred commissions.

"4. Any officer or employee of the Fidelity Investment Association knowingly violating these rules will be held to account according to law.

"Edgar B. Sims, Auditor and Ex Officio Insurance Commissioner."

Now, did you know that Mr. Sims had written that to the officers of Fidelity, Mr. Pulfer?

A. I have no way of knowing that. I was not an officer or director.

. . . . . .

[fol. 816] Q. You did not permit them earlier than two or three years ago to sell insurance as a side line, did you?

A. We never permitted them.

Q. I thought you told us about your salesmen selling insurance?

A. I did, but I did not say we permitted it.

Q. Well, you knew about it?

A. We discovered that.

Q. But did nothing about it?

A. We discovered it subsequently.

Q. You discovered it subsequently?

A. Yes, after some of these men had left us and had turned in their sales kits, and we found what was there. [fol. 817] We didn't know it at the time they were working.

Q. Now, you say there is a great appeal today to persons to save on the installment plan; is that right?

A. Yes.

Q. Do those persons demand to know or to look at the facts as to whether they will get their money back, after they save it?

A. I would think so.

Q. Did you know that 5.29% of the persons who invested in Fidelity, as discovered by the Securities and Exchange Commission, over a ten-year period, were all that received their money back at maturity?

A. No, I didn't know that.

Q. Would that have been something those people would have been interested in knowing?

A. Well, they might have been more interested in the company record—the complete record of the company in a ten-year period.

The Court: I want to find out something about that. I notice that question has been asked a number of times. I would like to know from this witness, or from some other witness, the cause for that small percentage who received their money back eventually. Was it because they paid in [fol. 818] a while and dropped it, or just that there had not been time yet for the contracts to mature, or that they had switched contracts and taken extensions in some other form, or something of that sort? What is the explanation of that small percentages of maturities?

Mr. Palmer: I think the Court is perfectly right. My figures are based on figures procured by the SEC by investigation of their statistics over a long period, and——

The Court: Well, do you, yourself, have any such information as that I have just asked for?

Mr. Palmer: Yes, sir; I have a copy of the hearing and the testimony of Mr. Fred Risley before the SEC in January, 1938.

The Court: Is he going to be a witness?

Mr. Palmer: I presume so; he is the president of the company; I suppose the debtor will certainly put him on the stand. I should think he would be one of the most important witnesses.

Mr. Fleming: No, he is not here, your Honor. If you want him I will be glad to have him subpoenaed, if I know where he is. I am not sure that I know where he is.

Mr. Palmer: I would think we would certainly want [fols. 819-830] to cross-examine him, under a motion of cross-examining the officers, before the trial, as being the most important officer of the company, the president, and the actual managing head. I had no thought but what he would be here, your Honor.

The Court: If he cannot be obtained today or tomorrow, we might as well wait until later to rule on that.

Mr. Fleming: I will be glad to endeavor to have him come in, if you want him.

Mr. Palmer: I would like very much to examine him.

* * * * * * *

[fols. 831-835] Q. Have you made any attempt to pay back the advances made to you, or have you repaid any part of the advances made to you?

A. I don't consider them as advances.

Q. My question is, have you repaid any of the money advanced to you?

A. No.

Q. They are still on the books of the company, of which you were a director, as a charge against you; isn't that right?

A. That is what you say.

Q. That is what I am asking you.

A. No, you are telling me that.

The Court: Answer the question, Mr. Pulfer. I want to get this examination through, and I don't want the wit-

ness to begin arguing with the attorney. Just answer the question.

A. Well, apparently they were.

. . . . . .

[fol. 836] Q. Mr. Pulfer, you are familiar with the fact that the company made deposits in the various states in accordance with the state laws; are you not?

A. Yes.

Q. Can you tell us what representations were made to prospective purchasers with respect to such deposits securing their contracts after they purchased them?

Mr. Fleming: The debtor objects as immaterial to the issue being presented at this time.

The Court: I cannot see that it is quite material to these issues, myself, Mr. Lauritzen. Will you explain why you think it is?

Mr. Lauritzen: Yes, sir. The sales literature and the sales presentation of the company, according to our information, laid the most heavy stress on state deposits, both with respect to the deposits made with the State of West Virginia, and the deposits made with every other state, and the law of West Virginia was quoted in that sales presentation, and the laws of the other states were quoted in that sales presentation. It was a trust fund on deposit with [fol. 837] those states, and according to our information——

The Court: You mean the literature said it was a trust fund?

Mr. Lauritzen: The literature and the instructions to salesmen, and the actual presentation by salesmen, and I think this witness can tell us of that phase of the sales presentation better than the literature—the actual selling conversations with the prospects.

The Court: How is that going to help the Court in determining the question we have at issue now, as to whether or not the Court has jurisdiction in this case, and whether or not the provisions of the statute have been complied with, and the petition filed in good faith?

Mr. Lauritzen: Just this, your Honor, if I may refer to one document here to illustrate my point. Here is a part of a presentation, referring to securities in the company's portfolio, and the last thing that is done with those securities, according to this presentation, is this, and I quote:

"Deposited with state departments for the exclusive protection of all contract holders."

Now, if those deposits are a trust fund, and if——

The Court: There is nothing said there about a trust [fol. 838] fund.

Mr. Lauritzen: Oh, but there is in the other part, your Honor.

The Court: All right; go on.

Mr. Lauritzen: I did not read it all. It is fully stated there, and I believe Mr. Palmer will bear me out that the sales presentation shows that there were trust funds on deposit to secure the cash surrender value; that when you came to get your cash from the company, at such time when you wanted it, in accordance with the table of cash surrender values, if, for any reason the company was not able to produce it, then these state deposits secured that to you, beyond any question of a doubt. Now, if that is what was done, and the contract was entered into between these purchasers and Fidelity, then those contract holders are entitled to have that cash in so far as the executed portion of their contract is concerned, and it is our position, as maintained in our answers, that no proceeding, reorganization, or otherwise, could abrogate that right to have that cash at such time as they wanted it, not on an extended basis, not on a modified basis, but exactly in accordance with the representations made to those contract holders. To us that is [fols. 839-843] a crucial point in this case, your Honor.

The Court: Let me see if I understand you, Mr. Lauritzen: Your contention is, that in view of the fact that the statutes of Wisconsin, we will say, provide for a 110% deposit, and then in selling in Wisconsin the salesmen told the purchasers of the provisions of the statute, and then the purchasers bought and paid in money on the contracts, that, then, in this proceeding, regardless of how much the company actually has to comply with what it said it was going to do, that all of those persons who purchased are entitled to be paid in full.

Mr. Lauritzen: In cash; yes, sir.

The Court: All right.

. . . . . .

[fol. 844] The Court: I cannot see how there could be any [fols. 845-857] doubt or objection to agreeing—of course, I

am not speaking for any of the attorneys—but that contracts were sold with the representation made that they were sold under the laws of the particular state in which they were sold, and that those laws would be complied with. Does anybody object to any such stipulation?

* * * * * * *

[fol. 858] Q. Can you give me the approximate number of shares of stock you owned in the company?

A. Oh, I imagine probably, in my name, ten shares of common, and fifteen shares of preferred.

Q. Now, is it not a fact that, from your knowledge of the affairs of the company at the time of that meeting in Pittsburgh, you knew there was no hope of you, as a stockholder, realizing anything on your stock by virtue of any plan of reorganization?

A. I have not been interested in the picture, from the standpoint of a stockholder.

[fols. 859-862] The Court: Answer the question and then give any explanation you wish.

The Witness: I was not interested in, and have not been interested in the picture from the standpoint of a stockholder, or getting anything on the stock I own; but primarily interested in seeing this company continue in business.

Mr. Palmer: If the Court please, I don't believe that is a fair answer to my question.

The Court: No; answer the question.

(Question read to the witness.)

A. I certainly understood there was not any possibility of realizing anything on the stock.

The Court: All right; now proceed, Mr. Palmer.

Mr. Palmer:

Q. Now, with that realization, with you and every other man in that room having that realization, nevertheless you voted for a resolution to put the company into a reorganization plan; did you not?

A. I voted for it.

Q. And it was voted for by every other man in that room?

A. That is right.

* * * * * * *

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[fol. 863] ALLEN G. MESSICK, having been first duly sworn as a witness, testified as follows:

Direct examination.

By Mr. Fleming:

Q. Give the Court your name, please.

A. Allen G. Messick.

Q. Where do you live?

A. Chicago, Illinois.

Q. Did there come a time when you had some business relationship with Fidelity?

A. There did.

[fol. 864] Q. When did you have your first contact with Fidelity, Mr. Messick?

A. About a year ago, or a year and a half ago.

Q. Where was that?

A. In Chicago, Illinois.

Q. Did you have a continuing relationship from that time on until you were elected chairman of the board?

A. I did.

Q. Briefly detail to the Court the character of your relationship and what occurred between your first contacting Fidelity or Fidelity contacting you, and up until the time you were elected chairman of the board of directors of Fidelity.

A. Mr. Pulfer met me on an occasion of a social meeting in Chicago.

Q. Did he present the Fidelity matter to you?

A. Yes.

Q. And then what happened? Did anything grow out of that meeting?

A. Out of that meeting we entered into a contract. Out of the conversation there we entered into a contract with Fidelity Investment Association wherein, after certain stipulations, we were to invest $500,000 in that venture,

[fol. 865] Mr. Rosset and I. We made considerable investigation on the representations made and at the end of considerable time came to the opinion that it was not safe at that time, it was impractical to go through with the contract for the reason that the evaluation of the portfolio, we differed in that evaluation as originally submitted; and it would involve—the corporation would be involved, in our opinion, in endless litigation, and also during that time the association was suspended from doing business in the State of Illinois and the State of Michigan, and others.

Q. The name of the corporation at that time was what?

A. Fidelity Investment Association.

Q. So that nothing was done about the rehabilitation at that time?

A. No, that is right.

Q. As I understand, the rehabilitation contemplated the putting in by you and Mr. Rosset of half a million dollars in new money?

A. That is right.

Q. And that was to be done under the conditions of the contract?

A. Yes.

Q. And after you had valued the portfolio and carefully [fols. 866-871] scanned the situation of the company and its business as it was being carried on at that time——

A. That is right.

Q. —you withdrew from your proposition, did you not?

A. That is right.

Q. Had that cost Fidelity anything? That is, did Fidelity expend any money by reason of your having entered into negotiations with them?

A. No, not to my knowledge.

Q. There was a certain amount of stock that was to be delivered; is that right?

A. That is right.

Q. Was the amount of stock agreed to be delivered ever delivered?

A. No, it wasn't. It was impossible. They could not deliver it.

Q. They were not able to gather up the amount that was to be delivered?

A. No.

* * * * * * *

[fols. 872-873] Q. And what amount were you to receive a month as chairman of the board?

A. They fixed my salary at $1,000 per month.

Q. Was Mr. Risley elected president of the company at the same time?

A. No, prior to that time.

Q. What was to be your capacity of work which you were to perform for the company?

A. I was to endeavor to rehabilitate and reorganize the company along the lines either by voluntary reorganization, if possible, of securing a uniform contract, and could make a complete revision of the portfolio and in general endeavor to rehabilitate the company.

. . . . . .

[fol. 874] Q. What else did you endeavor to accomplish during that period of about four months?

A. As I say, we went into the legal complexities of these various contracts, as stated in my letter, which I assume you will file; insisted on a complete disclosure, and to that end I talked first with Mr. Baines, I believe it was, of the Securities and Exchange Commission, stating frankly that we were wishing to reorganize Fidelity for the benefit of the people concerned, the contractholders, and then we later, some months later, as our plans progressed, we had our attorneys submit our proposed outline and plans of reorganization to the Securities and Exchange Commission in Washington and simultaneously with the Auditor of West Virginia here.

[fol. 875] Q. What did that comprise, Mr. Messick, briefly?

A. It comprised of taking every fund, segregating every fund as stated on our books, and evaluating them on a market basis and asking the individual contractholder to accept either a lien or a reduction in the amount due him according to the respective value of such fund as evidenced by the market value of securities in the fund.

Q. In other words, you evaluated the securities in each fund and you intended to allocate to each contract holder his equitable interest?

A. That is right.

Q. In that particular fund, whatever it might be; is that right?

A. Yes, and advising him of the exact situation and giving him the bookkeeping of that particular fund, if the Auditor and the SEC said that was satisfactory.

Q. Then in addition to that did you have the corporate charter amended?

A. We were of the opinion and advised that Fidelity could be converted to write insurance in addition to their savings plan contracts, and to that end we had the charter amended.

Q. And under that charter you intended writing insur-
[fols. 876-882] ance in addition to the business you had already been carrying on?

A. Yes.

Q. But as I understand, you never wrote any insurance, did you?

A. No, because the Auditor of State made an examination of us and had us under examination during that period and at the time of making — of asking the advice of the Securities and Exchange Commission, why, it became necessary in the judgment of the Auditor to file this action.

Q. Now, you spoke of having this portfolio evaluated by these various large banking institutions and their making recommendations for the changing of the various portions of that into what they thought was more advisable and better balanced securities; did these people you consulted make any charge to the company for their services, Mr. Messick?

A. The Continental Bank—well, all those respective institutions charged the company nothing.

. . . . . .

[fol. 883] Q. And Mr. Koontz advised the bringing of this proceeding in the state court in order that the affairs of the company might be rehabilitated; is that right?

A. Yes.

Q. And is that the reason the board of directors authorized or at least consented to the bringing of the suit, Mr. Messick?

A. We employed Mr. Koontz as our attorney to represent the company and endeavor to see that the proper reorganization was brought about for the benefit of the contract holders.

Q. After the state court receivers were appointed did you endeavor to cooperate and assist in every way possible?

A. I did to the fullest extent.

Q. In working out a reorganization?

A. That is right.

Q. And you spent time on that?

A. I did, considerable.

Q. What did you find in reference to it being very diffi-
[fol. 884-885] cult if not impossibe to move forward in view of the fact that there were a number of other state court receivers other than the receivers in the state court of West Virginia?

A. Owing to the authority of the state court, of course, stopping at the State line, the receivers—for example, in Wisconsin the receivers were maintaining one position; in Pennsylvania the receivers were maintaining another position, and so on in other states, so that they were conflicting and there were legal contentions that were conflicting, so that it appeared that the only solution to reorganize this company was to place it in a court under a central authority with jurisdiction over all.

Q. And with that idea in mind did you call a meeting of the board of directors in Pittsburgh on June 3, 1941?

A. I did.

. . . . . .

[fol. 886] Q. And who were present at that meeting?

A. Mr. John Marshall, Sr.; Mr. John Marshall, Jr., Mr. Howard E. Reed of Pittsburgh, Pennsylvania; Mr. F. H. Pulfer, Chicago, Illinois; Mr. A. L. King of Wheeling, West Virginia, and you were present by invitation, and Mr. McNulty. I believe that is everybody.

Q. And yourself?

A. Yes, of course.

Q. State briefly what was done at that meeting, Mr. Messick.

A. At that time, at that meeting, we convened and had a resignation from Mr. Foulk sent there, Thomas B. Foulk, and we elected Mr. Fleming to fill the vacancy and convened the meeting, the formal meeting, and considered the situation; a discussion for some hours, discussing the situation and decided to petition the United States District Court of West Virginia for reorganization.

Q. Something has been said about your bringing a resolution already prepared into that meeting for the purpose of having it adopted.

A. I brought no resolution and to the best of my recollection you dictated a resolution to the stenographer at the

[fol. 887] William Penn Hotel, when the meeting was recessed.

Q. And that resolution was later brought to the meeting while it was still in session?

A. That is right. We recessed and you went down and prepared the resolution.

Q. Then the resolution was voted upon?

A. That is right, the resolution which you prepared.

Q. Were there any opposing votes to that resolution in the meeting?

A. To the best of my recollection there were no opposing votes; unanimously carried.

Mr. Palmer: I will have to object. The minutes show that A. L. King did not vote, and I think attempting to impeach the minutes of the alleged meeting would be improper, by this witness.

The Witness: I thought Mr. Fleming's question was, was there any objection to that plan?

Mr. Fleming: That is what I thought I said.

Mr. Palmer: The record shows A. L. King did not participate.

The Court: I think the objection will be sustained as to that part of the answer attempting to contradict the minutes.

Mr. Fleming:

[fol. 888] Q. After that the meeting later adjourned, did it not?

A. Yes.

Q. And the petition was later filed in this district?

A. Yes, that is right. In the earlier part of the meeting Mr. McNulty attended as secretary.

Q. Tell us about that.

A. He brought the minute books and the vacancy was suggested and that Mr. McNulty be elected a director, and Mr. McNulty stated that he was a man who had to work for his living and he didn't feel like he could be a director of the company and at the same time be employed by the receivers, and on that statement he withdrew from the meeting and Mr. King was elected secretary of the meeting.

Q. Who were the members of the board of directors at that time?

A. It was Mr. F. s. Risley, Mr. Austin King——

Q. What about Mr. Burt?

A. Mr. Burt, yes, of Wheeling.

Q. Well, Mr. Burt and Mr. Risley were absent?

A. They were absent.

Q. And they were the other directors?

A. Yes.

Q. How did you arrive at that number? I think the min- [fol. 889] utes of the stockholders' meeting of that year, or the year previous, showed the election of 14 directors.

A. That is right, but a number of the men elected as director did not qualify.

Q. Refused to serve?

A. Yes.

Q. And that left these eight?

A. That is right; that left eight.

Q. At the time this meeting was held there were only eight directors?

A. That is right.

Q. And six of those were there?

A. Yes, six were there.

Q. How did it happen Mr. Burt did not come?

A. Mr. Burt informed us he was attending a telephone meeting at Charleston.

Q. What about Mr. Risley?

A. Mr. Risley, I was informed, wired he was unable to be there.

Q. In your judgment, from your experience with the affairs of Fidelity and your general business experience, do you feel that the affairs of Fidelity could be rehabilitated and a plan of reorganization developed that would be fair [fols. 890-899] and equitable and beneficial to the contract-holders?

A. I do.

Q. Explain that to the Court, please.

A. I feel that there is an inherent worth in the Fidelity idea; that is, of compulsory savings, and with that loyalty, if a plan is evolved that would make a return in line with present conditions—that is, it would be impractical in my judgment to have a reorganization plan that would pay 4%, 4½ or even 3%, I mean on establishing a reserve interest, but I do think that a reorganization could be accomplished if the portfolio was evaluated on a rock-bottom basis and if any changes necessary to convert the same, that is, take

away the speculative issues, were made, and then make the reserve return consistent with what the return on the securities was.

Q. That is, the present day earnings?

A. Present day evaluation; and in addition to that to also combine the new feature with it.

Q. And you think with a situation of that kind a plan could be developed, that is, could go forward successfully for the future?

A. I think so.

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[fols. 900-911] Mr. Palmer: Was there less than 60% of the common stock alone obtained, Mr. Marshall?

Mr. Marshall: I am not sure about that.

Mr. Palmer:

Q. Mr. Messick, it also says, "provided, that at the discretion of the parties of the second part, such a deposit of 50% of each class of stock may be deemed sufficient compliance herewith."

A. If we deemed it sufficient, I don't remember the provision exactly, but I think we could waive 60% and go down to 50%, yes. I don't remember that exact wording but of course that is right.

Q. You never waived that?

A. No, for the reason that our attorneys in Chicago stated that it seemed—I don't know, Fidelity said they would have to go outside the state of West Virginia to secure others, and our attorneys insisted on a registration, I believe, or consent of the Securities and Exchange Commission to solicit—I am not clear; some legal point which we would not waive.

• • • • • • • •

[fol. 912] Q. You did have several conferences with the Securities and Exchange Commission?

A. As I say, the plan of reorganization was a matter of full and complete disclosure to the Commission.

Q. It was impossible to give any practical plan?

A. No. I was not present at all the hearings. I helped prepare a lot of material and was in Washington at the time the Securities and Exchange Commission's position

was communicated to me by Mr. Calvert—I am not sure, I believe that was his name—which was that they were sympathetic to reorganization but in their judgment they did not think reorganization was practical, a voluntary reorganization was practical or equitable; that it had to be done by court procedure.

Q. Let me see if I understand your voluntary reorgani- [fol. 913] zation plan. Was it this: you were to value in each series the market value of every asset in that series; is that correct?

A. No, we were to do this: We were to put on a market basis—take every series on a market basis; then to lock up that fund and if there was any appreciation the contract holder got the benefit, but he was apprised at that time that the market value of that fund was "X" dollars and his equity was so much.

Q. Now against each series there were certain liabilities?

A. That is right.

Q. And you were going to write the contractholder and say we have so much, and so much liability?

A. That is right; that was the plan.

Q. And therefore, instead of your having $100 right against this fund, although you have a right to $100, we will have to scale it down to $50 or $75 or whatever your equitable share is?

A. Well, the thing was, it was just to give him a frank disclosure of the market value of his particular fund.

Q. Well, there were some funds that did not have as much money?

[fol. 914] A. There was a variance, yes.

Q. So that you were going to have to tell them, although you have $100, a contract for $100, we have only got $10 for you with which to pay it?

A. Nothing that extreme. We were going to tell them the truth about it, the true market value of the securities. That was what we were going to do.

Q. And tell them what their share as compared to others of that same fund was; isn't that right?

A. I don't understand.

Q. If the fund had $100,000 security market value, and it had $200,000 of contractual liabilities against it, you were going to tell each person that instead of his having on his contract what it called for you had only 50%, because you were going to divide that fund equitably among all?

A. We were going to make a full and frank disclosure, a complete bookkeeping statement of the various funds; I mean "X" number of contractholders in this fund, "X" number of assets, market value so much, and lock them up and hold them separately until—after he was apprised of the condition of the fund, his opportunity for cash surrender, then ask him if he thought it was better to go into [fols. 915-919] voluntary reorganization and take a chance on appreciation.

Q. That did not go through?

A. For the simple reason they felt, rightfully, that a voluntary reorganization of any kind—not just this one plan; there were several. Your firm worked very hard, Mr. Koontz gave it considerable time, he and I worked very closely on it and submitted it informally, not as a body, they were just helping us, the SEC, not hearing it formally, but they thought it was possible to be reorganized but it could not be reorganized except by means of a central jurisdictional authority.

* * * * * * *

[fol. 920] Mr. Palmer:

Q. Now, Mr. Messick, I understood you to say that just before the matter went into the state court Mr. Arthur Koontz was employed by the debtor to represent it in that proceeding?

A. Yes, we employed him at Wheeling.

Q. Now, the matter was handled in state court, and is it not a fact, and it has been so testified, that with the exception of one contract holder who intervened in the Kanawha County Circuit Court for the purpose of ascertaining what plan, if any, would be produced, there was not a single contractholder protested to the Circuit Court of Kanawha County concerning the handling of those affairs in receivership? Did you know that?

A. I don't know, no. I am not familiar with that.

Q. But without discovering that fact, that there had not been a single contractholder protest to the Circuit Court of Kanawha County, you nevertheless called a meeting to be held in Pittsburgh?

Mr. Fleming: I object as not pertinent or relevant and having nothing to do with the issues, and it is not cross-examination.

[fol. 921] The Court: Sustained. I do not see the slightest relevancy.

Mr. Palmer: If the Court please, I want to show the question of good faith of the debtor as represented by the board of directors, in that so far as the members who testified are concerned they have all testified they were interested in the contractholders, and that the reason that meeting was held in Pittsburgh, and the reason they filed this proceeding, was to protect the contractholders. Now, I want to find out about that meeting and what interest they had in the contractholders, and particularly the chairman of the board.

The Court: I do not think the fact that the contractholders had or had not written letters has anything particularly to do with that, and I will sustain the objection. (Exception.)

Mr. Palmer: May I make an offer of proof on the record of what the witness' answer would be?

The Court: You may state briefly whatever you want to on the record.

Mr. Palmer: The offer of proof is simply that the witness would answer yes to that last question.

* * * * * * *

[fol. 922] Q. Now, Mr. Messick, Mr. Fleming had been an old friend of yours; is that right?

Mr. Fleming: I am not ashamed of that, but it has nothing to do with the issue in this case.

[fol. 923] The Court: I will let that go in, but narrow it as much as possible.

A. That is right.

Mr. Palmer:

Q. At your suggestion he was at that meeting; is that right?

A. I invited him to that meeting, yes.

Q. And at that meeting he was selected the attorney for the company; isn't that right?

A. He was selected to file this bill.

Q. As attorney for the company?

A. In this particular instance, or this particular undertaking, that is right.

Q. At that time you had an attorney for the company representing you, Arthur Koontz, did you not?

A. Well, I don't know.

Q. I beg your pardon?

A. I mean, the point is this: We were informed in Washington that Mr. Koontz said that Mr. Sims would select or wanted an outstanding business man in West Virginia, and then a member of your firm—they were receivers. And then Mr. Koontz or Mr. Goldsmith or somebody here was representing the receivership, and I did not think that we could ask your firm to assume this burden too.

[fol. 924] Mr. Fleming:

Q. Let me ask you there: Is it not a fact that both Mr. Koontz and Mr. Wood were invited to attend that meeting, the same as I?

A. Definitely so, as was Mr. Thomas B. Foulk.

Mr. Palmer:

Q. Did you tell them the purpose of the meeting?

A. Definitely I did.

Q. You told them the purpose was to file a bill in federal court?

A. No, I did not tell them the purpose was to file a bill in federal court, but to consider the reorganization and all plans necessary for the reorganization.

Q. Had Mr. Fleming been your personal attorney?

A. Never.

Q. You brought an old friend of yours to the meeting and had him, who had never had any connection with Fidelity before, elected the attorney to bring the proceedings; is that correct?

A. For the reason Mr. Fleming had been United States Attorney for eight years in the State of Indiana, had been a leader in and had consummated some of the leading reorganizations in this country, and on that basis I asked him to come.

[fol. 925] Mr. Fleming: I move that the answer be stricken out, your Honor.

The Court: Overruled.

Mr. Fleming: I don't think I am a party to this proceeding yet. It is true I was elected a director, and I have been

embarrassed about that many times, but it seems to me——

Mr. Palmer: I am sorry we have to inquire about it, but certain issues are raised by our answer and we feel we have to go into it.

The Court: You may proceed.

Mr. Palmer:

Q. After that meeting who prepared the bill which was filed, if you know?

A. Mr. James Fleming, I think.

Q. Did you help him in any way?

A. No, I did not.

Q. Did you come to Charleston with Mr. Fleming when the bill was filed?

A. I did.

Q. On the morning of June 7, 1941, the Trustee qualified as such by accepting the trust and giving bond immed-ately thereafter and on the same morning it selected and recommended its general counsel to aid and assist in the adminis-[fol. 925a] tration of the trust.

Mr. Fleming: I object to that for the reason that is certainly a very moot question. Unless there is some matter of good faith or some matter or form of imposition that was practiced upon the Court, or upon someone, I fail to comprehend how this could have anything to do with the issues presented here.

Mr. Palmer: I will connect it up immediately.

The Court: I am assuming it is offered as bearing on the question of good faith, and it might have some bearing on that question, so I will admit it.

Mr. Palmer: And is not this true, that the Trustee filed a petition for authority to employ James B. Fleming and A. G. Messick, "for the purpose of assisting your Trustee in marshalling the assets of said debtor which are now situate in divers states outside the territorial limits of the State of West Virginia, and also for the purpose of assisting the Trustee in the development and formulation of a plan of reorganization for the affairs of debtor in this proceeding * * * and that this authority is requested under Section 157 of Chapter X of the Federal Bankruptcy Act." Is that not true, Mr. Messick?

A. Yes.

[fol. 926] Q. Had you requested the Trustee to so employ you?

A. No, I had not requested it.

Q. And is it not a fact that thereafter you and Mr. Fleming acting under such employment went to the State of Wisconsin and there conferred with the Banking Commissioner of Wisconsin?

A. We conferred—we went to Wisconsin, that is——

Mr. Reinhardt: Just a moment. If the Court please, I feel obligated at this point to point out that this question assumes a fact which the record, so far as I recall, does not establish yet, and that is that Mr. Messick was employed by the Trustee under the order permitting the Trustee to employ him.

The Court: That has not only been shown, but definitely stated by the Court, that no such employment was ever made.

Mr. Palmer: I want to ask Mr. Messick the question I last asked, however, if he did not go with Mr. Fleming to the State of Wisconsin.

The Court: You are asking him whether he went under that employment?

Mr. Palmer: That is what I would like to cross-examine Mr. Messick about, if the Court please. I don't want to [fol. 927] contradict the Court, naturally, but——

The Court: I don't think I will permit you to cross-examine anybody on a statement I make, and I do make that statement on the record, that there was no employment because I entered an order that there should not be.

Mr. Farmer: Then if he was just acting unofficially and as an interloper, we have a right to go into that.

The Court: All right, ask him that question.

Mr. Fleming: I object. How would that affect the issues here, anyway?

The Court: I will admit such a question as that, if it is asked. (Exception.)

Mr. Palmer:

Q. Did you go to the State of Wisconsin with Mr. Fleming and confer with the State Banking Commissioner and Mr. Lauritzen here?

A. I did.

Q. Did not you tell them you were employed by the Trustee at that time?

A. I think we stated we were authorized by the Trustee —I don't think Mr. Fleming or myself had any idea of any compensation for these services, as a matter of employment. We were doing the best we could to help.

Mr. Palmer: If the Court please, with that statement [fol. 928] may I pursue my cross-examination as to the employment wherein they stated they were authorized?

The Court: No, not as to employment, but you may pursue the examination as to what he did.

Mr. Palmer:

Q. What did you do there?

A. We had a conference and asked the department of Wisconsin to aid in reorganization.

Q. Aid the Trustee in a plan of reorganization?

A. That is right.

Q. Did you ask that the assets be turned over to the Trustee?

A. At that time, no, I don't recall; I don't know.

Q. The general tenor of the conversation was to ask the Banking Commissioner of Wisconsin to cooperate with the Trustee in reorganization under this Court?

A. And to cooperate with the Trustee, yes.

Q. Did you go with Mr. Fleming the following day to Chicago to the meeting of the commissioners of all states?

A. I was not with Mr. Fleming in that meeting.

Q. You went to Chicago with him but did not go to the meeting with him?

A. That is right. I was not in that meeting with him.

Q. Did you receive your expenses for that trip to Wis- [fol. 929] consin?

A. I did not.

Q. From anyone?

A. No.

Q. Have you made any claim for that as yet?

A. I have not.

Q. Were you authorized by the Trustee to represent it in Wisconsin?

Mr. Fleming: The debtor objects. I don't see how that is relevant. If Mr. Messick or myself had done anything that injured anybody, why, that would be something else;

or if any money had been paid out to us or anything like that, that injured anyone, that might be a different situation.

Mr. Palmer: Perhaps but for the intervention of Mr. Wood there might have been money paid out.

Mr. Fleming: Suppose there had been, Mr. Palmer, for expenses or for services, are you impugning the ability and the honesty of this Court by assuming that this Court would order the Trustee or anyone else to pay out money to Mr. Messick or myself unlawfully?

Mr. Palmer: I think the question answers itself. I impugn nothing wrong to the Court.

Mr. Fleming: I think you are. I think so, and if I have [fol. 930] done anything that has injured anyone I would like to know it, and if Mr. Messick has done anything to injure anybody, I would like to know that.

The Court: The Court does not consider Mr. Palmer's question is any imputation of anything with reference to the Court, but the Court does say that the question of employment is settled on the record. There is no such. Now, as to whether the Trustee authorized Mr. Messick to talk to these people, I do not see how that has anything to do with this case.

Mr. Palmer: If the Court please, the answer of the Auditor sets this up; that Mr. Messick came into this company without any interest and got a salary of $1,000 a month until the Auditor stopped it; that after the state court proceedings had been brought Mr. Messick, without contacting the contractholders in West Virginia, called a meeting of the board of directors, which the answer of the Auditor sets up as an illegal meeting, and that in that meeting Mr. Messick brought with him a friend of his, an attorney, and Mr. Messick then had a petition filed in federal court although there had not been a single protest in the state court in Kanawha County against the receivership there; that following that plan Mr. Messick came down here, presented [fol. 931] this petition to the Court, who, of course, accepted it on its face value and appointed a disinterested trustee and a disinterested attorney, and immediately following that the trustee presented an order for the employment of these two gentlemen who caused this proceeding to be brought, and immediately following that these gentlemen went to the State of Wisconsin and to Chicago, Illinois, to

the meeting of all insurance commissioners, in pursuance of that very plan set forth in this answer; and that plan is this, that the only possible way that could be thought of to get all of the assets into one court would be this: if a voluntary petition in bankruptcy were brought the law provides that the lienholders work out that matter themselves and turn over the proceeds to the bankruptcy trustee. If, however, a reorganization proceeding is brought the statute can be construed that one trustee can get all the funds in its hands and then if no plan can go through, having taken that money from the state depositories it will be turned over to the trustee in bankruptcy on order though by the persons who brought this proceeding.

The Court: I don't understand what you mean by "on order though by the persons who brought this proceeding." Do you think they would run the Federal Court?

[fol. 932] Mr. Palmer: No, your Honor, of course not.

Mr. Fleming: Then why do you say that? You are a man of intelligence, and why do you say that? I object. I have not assumed to do anything that would hurt anybody, certainly not to take any money off of anybody. I came before this group in Chicago, and I think probably some of you gentlemen were there, and I told them, I think, very plainly that I did not assume to represent the Trustees. Isn't that right, Mr. Jarecki?

Mr. Jarecki: As I recall. I don't recall exactly, Mr. Fleming.

Mr. Fleming: But whether I did or not, it is not important. What is there of importance about that, if I was acting in good faith, trying to do the best I could for everybody, why should I be, as it were, attacked?

Mr. Palmer: When Mr. Messick, the man who had no interest financially in Fidelity, calls a meeting of persons who had no interest in it, because their stock rights were entirely gone, for the purpose of taking it out of a court where there was no protest concerning it by the contract-holders, and bringing it into another court, and the following morning he himself and the attorney he has brought to that meeting are appointed by the Trustee for the duration of that [fol. 933] trusteeship to aid that trustee, we have a right to question the motives of that chairman of the board in calling that meeting and in filing that petition, and that is what we are doing, if the Court please.

Mr. Fleming: I don't think you are doing it successfully.

Mr. Palmer: That is not for you to judge.

May I ask a question about your appearing before that meeting in Chicago? Were you told and directed by any official of the Trustee to go out to Chicago and attend that meeting?

Mr. Fleming: No.

Mr. Palmer: You just went of your own accord?

Mr. Fleming: Yes, sir. Just as you might have gone, as representing contractholders, I went representing the debtor, and I endeavored to be fair with the people there, and I particularly appreciated the fine, generous spirit with which I was treated at that meeting.

The Court: So far as Mr. Fleming's going to that meeting, or any other meeting, in and about the business of trying to work out his reorganization plan that he has filed here—I don't mean his reorganization plan, but to advance the interests of the reorganization that has been petitioned [fol. 934] for—I cannot see any difference between that and the appearance of Mr. Farmer here today in this Court, or Mr. Palmer's appearance here today. Mr. Fleming is the attorney for the petitioning debtor and you gentlemen are attorneys for certain people who are opposed to the approval of the petition. Why should there be any argument on the record with reference to those things?

Mr. Palmer: I will be glad to disclose the reason I had in mind, that it was the day following the entry of this order, or a day or two afterwards, authorizing the Trustee to employ Mr. Messick and Mr. Fleming that they appeared in Wisconsin, and, as Mr. Messick says, informed the Banking Commissioner there—What was the exact wording he used with reference to the Trustee, Mr. Reporter? That he was authorized to——

Mr. Fleming: Just a moment. I will say why I went to Wisconsin, and it was without any obligation on the part of the Trustee or Mr. Townsend. Mr. Townsend called me by telephone. The Wisconsin authorities were about to sell securities and we went up there, rather a committee, because I was requested to go up there; and I went up without any obligation on the part of the Trustee or Mr. Townsend or anyone else, and I paid my own expenses and I was glad [fol. 935] to meet the Wisconsin authorities. I thought their attitude was both intelligent and generous. That is what I thought about the attitude of the Wisconsin authori-

ties, and after that I found that same situation in Chicago. Tennessee told me that they were going to hold on to these securities until virtually the last dog was dead, and I think they meant it, but I want to say that when I walked into that meeting I felt a spirit of great hostility toward me as the debtor's attorney, and when I left I felt that at least I had had a friendly hearing, to which I was, I thought, entitled.

The Court: Well, I think this argument has proceeded far enough. Is there anything further with Mr. Messick?

Mr. Palmer: If the Court please, may I have this question on the record——

The Court: If you have a question, yes; otherwise, just argument, no.

Mr. Palmer: Mr. Fleming stated he was asked to go to Wisconsin. I want to ask him what person asked him, and whether that person was connected with the Trustee, to go to Wisconsin.

Mr. Fleming: Yes, Mr. Townsend called me by telephone and I went without any obligation on the part of anyone, and I did the thing I thought was best for the debtor and [fol. 936] for the Trustee and for the contractholders, and for everyone connected with this proceeding.

Mr. Palmer:

Q. Mr. Messick, I had asked you, I believe, and as I recall you answered, that in appearing before the Wisconsin Banking Commission you told the Commission you were authorized by the Trustee to appear there to talk with them.

Mr. Fleming: I object.

The Court: Overruled. (Exception.)

A. I drove Mr. Fleming up there to meet with the Banking Commission. Mr. Fleming communicated to them the purpose of our visit, as I recall.

Mr. Palmer:

Q. Did not I ask you on the record, and did not you state, that you told them you were authorized to appear there for the Trustee? Didn't you answer that just a few minutes ago?

A. If I did it was a mistake. I mean I had no capacity there; just a friendly discussion with Mr. Fleming and we might have said—I don't really recall, except we were

trying to abate that situation, get Wisconsin to cooperate with us and not sell these securities.

Q. "With us"? Whom did you tell them you were representing?

[fol. 937] Mr. T. C. Townsend: Your Honor, I object. I think this has gone far enough, and entirely beyond the bounds of cross-examination.

The Court: Overruled. (Exception.)

A. I don't recall.

Mr. Palmer:

Q. As a matter of fact, did not you tell them you represented the Trustee in reorganization? Answer that question yes or no, please.

A. I don't recall; just a friendly meeting, an informal meeting.

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[fols. 938-939] Q. Now, what chance would such a contract have in being sold as against defense bonds which yield 2.9, and which have the backing of the United States Government?

A. In my opinion, I think the thing that sells these contracts is the savings feature. I don't think the interest requirement—and I am advised by several leading salesmen to that effect—I don't think the interest feature is of the greatest interest. The compulsory savings feature is the idea.

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[fol. 940] Q. And whether it is like a Christmas Club, with no interest, but compulsory or semi-compulsory, a systematic savings plan, you think that would work?

A. Yes, sir; I do.

Q. But you cannot see where there would be any profit in it for any one to invest money in it?

A. No, I definitely think a company can be founded on compulsory savings and yield a safe return.

Q. My thought is this, that a person who would put up capital for such company would have no chance to make any [fol. 941] money because the yield would be so low even to the investor that——

A. (Interposing:) Oh, no, they could make money, a very conservative yield; and I think capital stock would be rated, if you can rate a common stock equity, as a conservative investment.

Q. You would not put your $500,000 into Fidelity as it was, would you?

A. As it was, on a 4½% return, no, because the record shows you cannot do it without investing in speculative securities.

Q. And it required, as you found out from your investigation, an expensive sales campaign with heavy expenses to put it over, did you not?

A. I don't agree with that. I was very critical of that.

Q. You found out that is what they had done, didn't you?

A. No, their sales—their past history was that they had spent more than I would have; what I called promotional sales.

Q. That is what I mean, their past history shows, right or wrong, that they had spent a very heavy sum for pro- [fol. 942] motional sales?

A. That is right, in my judgment.

Q. And that regardless of whether it produced results or not, they spent too much, in your opinion?

A. In my opinion I think that the company had no chance on that high yield that was expected and the excessive promotional sales expense.

Mr. Palmer. That is all I care to ask, your Honor.

By Mr. Lauritzen:

Q. Mr. Messick, when you and Mr. Fleming came out to Wisconsin you had a discussion with the Chairman of the Banking Commission of Wisconsin and myself, did you not?

A. Yes.

Q. And various plans and prospects were discussed and you wanted to get our attitude and you conveyed to us something of your attitude; is that correct?

A. Yes, it was an informal meeting; thinking out loud.

Q. You expressed the idea there that you were fully aware, in order for this company to get anywhere in the future, they would have to have the full sympathy and cooperation of the various states in which they operated, including Wisconsin; isn't that right?

A. Yes.

[fol. 943] Q. You testified a while ago as to a voluntary reorganization you had been turning over in your mind and had discussed with the SEC or others?

A. I did.

Q. Of segregating everything into funds and telling everyone what they had and then frankly putting it up to them and having them write it down on a re-listed basis?

A. That was the plan, one of the plans suggested. Several were suggested.

Q. In connection with the loss on such a plan did you consider whether such a plan could be put over in states where the contracts were 100% secured by the deposits made for that express purpose in those states? Did you feel that in some way that deposit there could be abrogated and that you could get the contractholders to write down their equity in the particular fund upon some voluntary plan or other?

A. We felt like this in regard to particular states, as regards particular classifications of contracts, I mean, of the five or six they had, we were going to submit a voluntary plan based on the cash surrender—an option of doing such and such. It was not regarded as any state jurisdiction but as regards the particular classification of the different contracts.

[fol. 944] Q. Then you did not consider that that would perhaps be impossible with respect to contractholders who were 100% secured in particular states, or did you?

A. That is the point where lawyers differ. I have asked several lawyers as to the various rights of various states, and I don't know.

Q. If it was a fact that contractholders in some states were absolutely secured to the full extent of their contracts by deposits in those states, then even such a voluntary plan as you proposed and had discussed would necessarily fail, would it not?

A. I would think so. I don't know the final figures, so many securities have depreciated, but I would say this: Certainly if one state is in such position that they would get 100%, I would think they would take the 100%. I have no opinion really because I think it is a question for a court to settle.

Q. But assuming that they had the 100%, that would be the result, wouldn't it? That is, you could not expect a man to come in and scale down if he had 100% in his own state,

could you? You couldn't get him to do that, could you, Mr. Messick?

A. I guess that is obvious, isn't it? I would think so, [fols. 945-947] yes, but it is also a question of law.

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[fol. 948] By Mr. Farmer:

Q. May I infer from your answers that you have moved around in financial circles to a considerable extent, Mr. Messick?

A. Well, to a modest extent, yes.

Q. Among the banks of New York, Chicago and other places?

A. Well, I have friends and I guess I am known there.

Q. And you have promoted the Farnsworth Television Company?

A. I was one of the organizers of the Farnsworth Television Company.

Q. And the other company back of that was the General Household Utilities?

A. I had nothing to do with the promotion of it. I represented various financial interests which advanced money to that corporation.

Q. Capital?

A. That is right. I mean loaned money, not invested capital.

Q. What was the business of that company?

A. Manufacturing refrigerators and radios and electrical appliances.

Q. When did you first become connected with that com-[fol. 949] pany?

A. 1934.

Q. Prior to that time what business were you in?

A. Prior to that time, until 1934—the latter part of 1930 to 1934—I was with Mrs. Messick during her last illness in California, an inactive time; and prior to that time I was organizer and chief executive of the United States Radio Corporation, which made radios for General Motors; and prior to that time I was a lawyer and interested in various manufacturing institutions.

Q. Where did you practice law?

A. Marion, Indiana.

Q. What years?

A. I practiced from 1912 to 1927.

Q. Then you gave up the practice of law there and went into the manufacturing business?

A. That is right.

Q. With the United States Radio Company?

A. Yes.

Q. Did you organize and promote it?

A. Organized it and one of the principal stockholders.

Q. You put your money in it?

A. I did.

[fol. 950] Q. And got other people interested in it?

A. A local enterprise.

Q. Is that still functioning?

A. It is now part of the Farnsworth company, the Marion plant.

Q. You merged them or something?

A. Yes, we merged them.

Q. Well, you have talked over this Fidelity situation, I take it, with bankers in New York and Chicago and all these other places you have been, when you went over the portfolio; is that right?

A. Yes, I have, generally.

Q. That is, the troubles they were having?

A. Well, it was a matter of general knowledge pretty well around; in the papers.

Q. You mean the bankers already knew of the company?

A. Yes.

Q. And of their trouble?

A. Yes, sir; I think every bank of any size has a credit file on Fidelity.

Q. Were you contemplating then putting new money, new capital, in the company?

A. We contemplated putting additional money in the [fol. 951] company.

Q. And for how many years have you been turning that over in your mind?

A. When I first started it was a year and a half ago.

Q. A year and a half ago?

A. Yes.

Q. And that is common knowledge among banking circles?

A. I don't say common knowledge. I don't think I am that important. I would say among the people I know.

Q. That is, people who have money to invest?

A. No, people that know me, that I have talked to, prob-

ably know I have been active there. I don't think I am important enough to be common knowledge.

Q. You did not consider at Pittsburgh when you adopted this resolution to try to get the company reorganized down here, the possibility of putting new money into it?

A. We discussed that. We considered everything from time to time, but as I said, I don't think Fidelity on this present set-up of high interest yields can be economically and safely run. I think it needs to be reconstructed and reorganized.

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[fol. 952] HARRY B. HOBSTETTER, having been first duly sworn as a witness, testified as follows:

Direct-examination.

By Mr. Fleming:

Q. What is your name, please?
A. Harry B. Hobstetter.
Q. Where do you live?
A. Wheeling, West Virginia.
Q. Are you employed by Fidelity?
A. Yes, sir.
Q. How long have you been employed by Fidelity?
A. Twenty years.
Q. When did you first enter the employment of Fidelity?
A. In September, 1920.
Q. In what capacity?
A. At that time I began as a clerk.
[fol. 953] Q. In what department?
A. In the posting department.
Q. Just explain to the Court what progress you made from time to time, and what changes were made in the course of your employment.
A. Well, from that time on I advanced through every department in the association until eventually I was made office manager by the president of the company and the chairman of the board.
Q. How long have you been office manager?
A. Since April, 1940.

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Q. Briefly tell the Court what your duties were as office manager.

A. Well, I was in charge of the operating division. That meant that it was my job to see that the affairs of the association were handled in an efficient way; for instance, the mail, when it came into the office was supposed to be handled the same day that it came in, if possible, and all collections that were received from contract holders were put through promptly; to see that the postings were made promptly, and correspondence answered by the people in charge of answering the correspondence.

As a matter of fact, it was my duty to see that the opera- [fols. 954-966] tions of the company did not hit a snag and that they were handled in an efficient manner.

Q. Prior to your becoming office manager, what did you do?

A. I answered correspondence chiefly.

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[fol. 967] Mr. Lauritzen: This does bear on the issues raised by our answer, the fact that the petition here was signed by John Marshall, Jr., and I just wanted to ask as to the office he held and the nature of the duties.

The Court: All right; go ahead.

Mr. Lauritzen:

Q. Will you answer the question?

A. Did you ask when he came to Fidelity?

Q. Yes.

A. Around January, 1938. Prior to that time he was in Baltimore,

Q. Working for Fidelity?

A. That is right.

Q. Do you know how long he had been with Fidelity in all?

A. You mean the total of the years?

Q. Yes.

A. I would say seven or eight years.

Q. And in 1938 he came down to Wheeling?

A. That is right.

[fol. 968] Q. And what was his position at that time?

A. Vice President.

Q. What had his position been in Baltimore, if you know?
A. He was manager of the Baltimore district.
Q. That is, for sales?
A. Yes, for sales.
Q. Had he taken an active part, himself, in making sales of contracts?
A. In selling; yes, I understood he had. Of course, I don't have any way of knowing, I was not over there, but I understood he sold contracts and also trained men to go out and solicit business.
Q. What were Mr. John Marshall's duties when he came down to Wheeling as vice president?
A. Well, he had several duties. He had charge of purchasing. He answered correspondence and he interviewed clients of Fidelity—several duties.
Q. Do you know what his experience was previous to that time in that sort of work?
A. Well, in the selling business you have a lot of experience, I would say, in getting the human slant on things. He was very well equipped, when he came to Fidelity.
[fols. 969-974] Q. Would you say that that kind of experience would qualify you in purchasing supplies for the company?
A. Well, that was not his only duty.
Q. But that was one of them.
A. That is right. He was very good.

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[fol. 975] WALTER J. GRIBBEN, having been first duly sworn as a witness, testified as follows:

Direct examination.

By Mr. Fleming:

Q. State your name to the Court, please.
A. Walter J. Gribben.
Q. Where do you live?
A. Wheeling, West Virginia.
Q. What is your occupation?
A. Auditor of Fidelity.
Q. How long have you been auditor of Fidelity?
A. Approximately fourteen years.

Q. As such auditor, explain to the Court briefly what [fols. 976-991] your duties were.

A. Well, my duties have been mainly the details of the general records and the handling of the insurance phase of the Series B Contract, also much of the duties of Fidel.

Q. Now, particularly since 1937, are you acquainted with the fact that Fidelity had a number of unusual or extraordinary expenses over and above those incurred in the usual course of business; for instance, attorneys' fees and actuarial fees and auditors' fees, and any other fees?

A. Yes, sir.

Q. Explain those to the Court, if you will, Mr. Gribben.

A. Well, particularly since 1938, with the number of attorneys that have done work for the association, there has been rather an unusually heavy attorney fee; and, in addition to that it was necessary to have auditors come in and examine the books and records of the association, which resulted in rather heavy auditing fees, also.

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[fols. 992-1100] Q. Now, Mr. Gribben, I am going to ask you to prepare for me from the books of Fidelity, for introduction in this case, all of the attorneys' fees spent by the company during the last twenty years, including those of Mr. Marshall when he was your attorney, and any one else, as well as the expenses which were paid for Mr. Marshall, or any one else, for their offices as part of their rent, as stenographic fees and so on, for the last twenty years. Can you prepare that from the books of the company?

A. I believe so.

The Court: How long back?

Mr. Palmer: Twenty years, your Honor.

The Court: That is going back too far, I think.

Mr. Palmer: All right; say the last fifteen years.

The Court: No, I think ten years would give a fair impression of what the average would be.

Mr. Palmer: All right, sir.

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[fols. 1101-1125] H. Isaiah Smith, recalled as a witness by the debtor, testified as follows:

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[fol. 1126] Q. Did you give us the liabilities of the general fund, Mr. Smith? You gave us the total assets. Did you give us the total liabilities?

A. The balance sheet shows a deficit in the net worth of the capital stock of $1,391,230.15.

Q. You say of the capital stock?

A. That is right.

Q. Do you mean by that——

A. Capital and preferred stock.

[fol. 1127] Q. The general fund is at least $1,391,000 in the hole—I say, at least that?

A. Yes.

Q. And by what you have given us before with reference to other valuations, it would be approximately at least two million dollars in the hole?

A. Let me correct my statement on $1,391,000. It wouldn't be that high, because that includes a reserve of $750,000 to secure the note of National Sales Agency.

Q. That note is not worth more than the paper it is written on, is it?

A. No, I say it has been transferred. It increased this $1,391,000 by transferring it as a reserve against this note. That is a liability: they are not holding it as an asset. If you wipe that reserve out, then your deficit in the general fund would only be $640,000.

Q. And you need that reserve, because we know the note is not worth anything.

A. I know the reserve is good.

Q. And you know that there is at least another half million dollars, I think you told us, between book value and actual value in the assets which is not reflected in that [fol. 1128] deficit figure you have given us? Isn't that correct?

A. That is right.

Q. And there is probably a further deficit as shown by the real estate, is there not, in your opinion?

A. No, because the real estate has been mortgaged to the various contract funds. Of course, there would be a deficiency there; if the contract funds would foreclose, they would probably come back with a deficiency on the general fund.

Q. And the amount to which it is mortgaged to the contract funds, can you say, in your opinion, whether or not they would realize that much from them?

A. I doubt if they would.

Q. So, in other words, there is shown roughly at least two million dollars of deficit in the general fund—I say, roughly, taking everything?

A. No, it wouldn't be that high. I corrected this figure here to the extent of three-quarters of a million dollars. It couldn't be two million dollars, because the book value of the assets is $2,311,000.

Q. Will you give me a fair approximation of what you believe the deficit is?

[fol. 1129] A. It is my opinion—I am saying this is roughly—but it is my opinion that the assets in the general fund would be worth in the neighborhood of a million dollars against a liability of $2,311,000.

Q. From your work with the Fidelity Company, have you ascertained, or has the trustee ascertained or the West Virginia State Court receivers ascertained the exact amount of money that each contract holder had coming due him as of a given date by virtue of his contract?

A. That is in the exhibit of our creditors filed at the August 5th hearing.

Q. That has been worked out as of what date?

A. As of June 6th. However, the reserves, I believe we qualified our statement when it was filed by saying that there had been no improvement in the reserves since April 10th 1941.

Q. Mr. Smith, you also know, do you not, all of the assets of the company applicable to those liabilities? Is that correct?

A. That is right.

Q. And you also know the assets of each fund as shown by the books of the company applicable to the liabilities of each series fund? Isn't that true?

[fol. 1130] A. That is right.

Q. And you have also broken it down, have you not, so that there are shown the liabilities to the contract holders of each State, and the funds deposited in that State applicable to those liabilities?

A. I think that has been introduced in testimony.

Q. Mr. Smith, you were and are one of the West Virginia State Court receivers, is that correct?

A. That is right.

Q. The other receiver, whom I note to be absent from the hearing at the time this question is asked you, is Mr. Ross B. Thomas? Is that correct?

A. That is right.

Q. Will you give the Court an idea of the capability of Mr. Thomas to serve with you as a receiver in the State Court?

Mr. Fleming: To this the debtor objects.

The Court: What is the pertinency of that, Mr. Palmer?

Mr. Palmer: Your Honor, whether there was a prior proceeding pending under Section 4, I believe, of the Bankruptcy Act—146, Section 4—so that the Court would have an idea in arriving at its opinion as to whether or not [fol. 1131] those who were handling it in the State of West Virginia are capable—capable in a small degree or a greater degree—of carrying on a reorganization proceeding. I think the Court wants to inquire into that matter—and the coreceiver would probably be the best one to——

The Court: Let me see that section a moment and see what it does say.

(Mr. Reinhardt hands pamphlet to Court.)

Mr. Palmer: 146.

The Court: I will overrule the objection.

Mr. Palmer: Do you have the question in mind, Mr. Smith?

The Witness: Will you read the question?

(The question was read.)

A. I found Mr. Thomas very helpful. We more or less divided our work, in that the financial end, I looked after it, and he advised with me on the legal aspects, and since he had worked considerably with the company in previous years in preparing the statement for registration with the Securities and Exchange Commission, he was very familiar with the affairs of the company; it made him quite helpful to me. Now, as to what I was to him, I don't want to say.

Mr. Palmer: I am not going to ask you about yourself, [fol. 1132] Mr. Smith, but did Mr. Thomas, at the time of

the appointment and throughout your work, have in mind the entire legal setup of Fidelity, would you say?

A. He seemed to have, yes.

Q. And did he have in mind or learn of the various liabilities to the contract holders?

A. Yes, we would go over those statements together.

Q. Had you prepared, as West Virginia State Court receivers, the liabilities of the company to each contract holder as of April 10th before you were relieved of your duties?

A. We had not prepared a list similar to that submitted by the trustee for the August 5th hearing—that is, the contract holder's name and address and his liability—but we had prepared statements of the total liabilities by funds.

Q. By States?

A. By States, yes.

Q. And were you collecting the assets of the company in West Virginia? Had you already collected them at the time you were relieved on June 6th?

A. We had in our possession all the assets in the State, [fol. 1133] except the assets on deposit with the State Treasurer of West Virginia.

Q. Had you been in correspondence with and in touch with the various other State commissions and State insurance commissioners or State depositories and their attorneys where ancillary proceedings were going on?

A. We had general correspondence with most of them, I would say.

Q. And they were corresponding with you and you with them, is that correct?

A. Yes. A number of times they had asked us for a list of contract holders for their States and so forth, and we were in correspondence in that respect more than anything else, I would say.

Q. Were you furnishing what they required or asked of you?

A. We had not furnished a list of contract holders by States.

Q. You were preparing or prepared to do that if the need arose therefor?

Mr. Fleming: This has all been covered, your Honor, in the previous examination in rather close detail, is my [fol. 1134] recollection.

The Court: I don't remember that it has been. I think Mr. Palmer has a purpose in this, to show, if he can, that under Subsection 4, Section 146 of Chapter 10, there was a prior proceeding pending in which the interests of all parties would be best subserved. That is the purpose, I take it?

Mr. Palmer: That is right.

The Court: And for that purpose I will permit this witness to answer such questions as he can answer.

A. Of course, we would have prepared the list. We felt, however, that before doing it, the Circuit Court should authorize making the expenditure and the cost of the preparation of the list.

Mr. Palmer: Isn't it true that you were from time to time filing your reports with the Circuit Court of Kanawha County as to the progress of your work?

A. That is right.

Q. And I believe one report of more than fifty pages concerning your work was prepared and filed? Is that correct?

A. That is right.

Q. And were you conferring with both Auditor Sims and [fol. 1135] Judge Bouchelle of the Circuit Court during your work?

A. Oh, yes.

Q. You didn't attempt to take into your possession any of the assets of the other State depositories? Am I correct in that?

A. We attempted to get some cash that was on deposit—small amounts—corral the cash under the Court's jurisdiction, but did not succeed in all cases. We didn't get any securities nor attempt to get any securities from any of the States.

Q. Isn't it a fact, Mr. Smith, that you and Mr. Thomas did act as fully with regard to Fidelity as you have been permitted to do so far in the present case?

The Court: I didn't understand that.

Mr. Palmer: In this, your Honor, that Mr. Smith, as I understand, is an employee of the trustee, and that under the West Virginia receivership they acted as fully with regard to the affairs of Fidelity as the trustee has so far acted or been empowered to act in this present proceeding.

with the exception of the injunctive part of the Court's order.

Mr. Fleming: The debtor will object.

[fol. 1136] The Court: In that question you lose sight of the fact that the matter of the Court's jurisdiction is still pending, and that while that is pending, the trustee is not pursuing the activities that would be pursued if it were determined that the Court had jurisdiction.

Mr. Palmer: That was the purpose of my question. I tried to phrase it to show that up to the present time, under the Court's authorization, that the West Virginia State Court receivership acted as fully as has the trustee been permitted by the Court up to the present time.

Mr. Fleming: It calls for a comparison, your Honor, which I don't think is proper.

Mr. Palmer: I am asking him as a question of fact, not a question of opinion or law.

The Court: I sustain the objection to that question on the grounds I have just indicated.

Mr. Palmer: I would like to make proof of the question and ask the witness to answer so I can vouch the record by his answer. Can you answer, Mr. Smith?

A. Of course, the trustee is not acting, or is unable to get securities into their hands, not because we would not like to, or the trustee would not like to, but the Court has [fol. 1137] frozen those securities in a way that the trustee can't get them.

Q. My question is, Mr. Smith, of which I want to make proof on the record, isn't it a fact that you and Mr. Thomas, as West Virginia State Court receivers, acted as fully and as in great detail in your work as such receivers as has the trustee under the present rulings of the Court?

Mr. Fleming: That is the question I objected to.

The Court: I sustain the objection, but he is offering this on the record, which I will permit him to do.

A. I would say we were, in view of the fact that the trustee is being restricted, under the Court order, from operating——

Mr. Palmer: The point I want to bring out—this is still on proof—is that up to the present time the West Virginia State Court receivers were able to act as fully about Fidel-

ity's matters as has the trustee under the rulings of the Court up to the present?

Mr. Fleming: I submit that the witness has answered this question and is being pressed, apparently, for another answer.

Mr. Palmer: I am making proof under the Court's ruling [fol. 1138] as to which he sustained the objection.

The Court: I have sustained all the objections.

Mr. Palmer: Will you read the question.

(The question was read.)

A. Yes.

Q. If you had been permitted to go on as West Virginia State Court receivers, Mr. Smith, were you and Mr. Thomas prepared to carry on your duties fully as permitted you by the laws of the State of West Virginia and the instructions of the Auditor and under the direction of the Circuit Court of Kanawha County?

A. I think so.

Q. I am not certain as to whether this next question has been covered or not. Isn't it a fact that, other than the one contract holder, who asked that he be notified before any plan was approved, that there was no other objection filed in the Circuit Court of Kanawha County to the proceedings therein pending?

Mr. Fleming: The debtor objects to that. The very same question was asked.

The Court: That has already been asked and answered.

Mr. Palmer: Then withdraw it, please. I wasn't certain [fol. 1139] of that, and I do not want to encumber the record.

The Court: Mr. Price, let the record show that the Court changes its ruling as to the admissibility of the testimony as to how the State receivers conducted the business in comparison with how the trustee has conducted the business and permits that to go in, overruling the objection.

Mr. Palmer: And the offer of proof can now stand as the testimony without giving it again?

The Court: Yes.

Mr. Palmer: Mr. Smith, on page 25 of your answer, you set up that, "The various States in which the debtor has engaged in business provide a complete and adequate means of liquidation of insolvent companies such as the debtor by

Courts of competent jurisdiction, and that upon disinissal of the proceedings herein, if no reorganization can be effected, the State Courts could locate the assets of the debtor within their respective jurisdictions and distribute the sum of money to those creditors entitled thereto, without the necessity of incurring the unnecessary expense and delay and multiplication of plenary suits and so forth." Can you state whether or not you and Mr. Thomas, had it been found that reorganization was impossible, as State [fols. 1140-1149] Court receivers, together with Mr. Sims, were prepared to carry on the duties of liquidation under the statutes of West Virginia?

Mr. Fleming: To this the debtor objects. That has been answered.

The Court: I am not sure. I will overrule the objection.

A. Yes, I think so.

Mr. Palmer: Waiving aside your natural modesty for the moment, do you think that you and Mr. Thomas were capable of performing your duties?

A. I think so.

* * * * * * *

[fol. 1150] Q. Mr. Smith, I believe you and Mr. Thomas were State Court receivers. What is Mr. Thomas' first name?

A. Ross.

Q. Ross Thomas?

A. That is right.

Q. And with what law firm has he been connected for some time?

A. The law firm of Koontz & Koontz in Charleston.

Q. And was he connected with that firm at the time he was appointed receiver of Fidelity?

A. Yes.

Q. And did he continue as a member of that firm after [fol. 1151] his appointment as receiver?

A. I don't know his relationship with the firm. I know that he devoted practically all of his time to the work of the receivership, either here or preparing reports for the receivers here in Charleston.

Q. But he worked out of Koontz & Koontz' office, as I understand?

A. Yes, sir.

Q. I assume that after you were appointed receivers, you petitioned for the employment of Koontz & Koontz as attorney for the receivers?

A. That is right.

Q. And they were named by the Court as attorneys for the receivers?

A. That is right.

Q. Did you know at that time that the Koontz firm had been attorneys for Fidelity for several years?

A. No, I didn't know it.

Q. Did you know at that time that they had received fees approximating, say, ninety-two or ninety-three thousand dollars for the three years prior to the time they were employed by you and Mr. Thomas as attorneys for your-[fols. 1152-1153] selves as receivers for Fidelity in the State Court?

A. No, I didn't know that.

Q. You know it now, do you not?

A. It has been developed during this hearing.

Q. And they are still representing the receivership, aren't they?

A. That is right.

Mr. Palmer: If your Honor please, I move to strike those last questions as being irrelevant to the subject under discussion.

Mr. Fleming: I think they are highly important, your Honor.

The Court: It seems to me, Mr. Palmer, that that is proper cross-examination on the matter that you brought out, as to whether there is a proceeding pending in which the interests of all parties will be best subserved, and you asked the questions.

Mr. Palmer: I think the Court is probably right in that. I withdraw the objection.

* * * * * * *

[fols. 1154-1161] The Court: Before you go into that, there is one other question I want to ask about Mr. Thomas and his connection with this company. I understand from your answer, Mr. Thomas had a great deal of familiarity with the affairs of the company. I would like to find out, if you know, what led to his familiarity with its affairs.

A. I think Mr. Thomas did a good deal of work with reference to the preparation of the statement that was filed

with the Securities and Exchange Commission, looking towards registering the company.

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[fol. 1162] Q. Mr. Smith, did you ever see the large printed or typewritten report prepared by Mr. Ross Thomas for filing with the Securities and Exchange Commission?

A. Yes.

Q. And about what size book or volume is it?

A. Oh, it is a large volume—let's see. To give the dimensions from memory, I would say it was—oh, it was about ten by twenty inches. That is a guess, ~~and about~~ possibly two and a half or three inches thick.

Q. Containing approximately how many pages?

A. I wouldn't know, Mr. Palmer. I have seen the report.

Q. Was that report printed or typewritten?

A. Printed.

Q. Did that printed report contain practically all of the activities of Fidelity which you and he could use as a basis or guide for your work as State Court receivers?

A. Yes. It was very helpful to us; it covered the details.

Q. And did the compilation of that report indicate a very [fols. 1163-1167] deep research into the financial and other workings of the Fidelity Company?

A. It did.

Q. From seeing that report and knowing of its preparation by Mr. Thomas, did you come to the conclusion that he was thoroughly familiar with all the details and ramifications of the Fidelity Company?

A. I did.

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[fol. 1168] Q. During the period April 10th to June 6th, 1941, did the value of the assets in Charleston ever drop below $9,992,985.79, which is the figure shown on your schedule of assets as of April 10th, 1941?

A. No, we made no withdrawals of securities.

Q. The coupons that you, as receiver, clipped during the interim between April 10th 1941 and June 6th 1941, did they include coupons appertaining to securities that were on deposit with the State treasurer of the State of West Virginia.

A. That is right.

Q. Did they include any other securities?

A. I don't recall whether or not we cut any coupons during that period from free securities that were held in our vaults or not. If we did, it would be a small amount.

[fol. 1169] The Court:

Q. Mr. Smith, do you know who had been cutting the coupons from those securities since the time in May that the receivers took over?

A. To my knowledge, Your Honor, there had been no coupons cut since that date on the West Virginia deposit.

Q. Have there been maturing coupons from time to time since then?

A. Oh, yes. The June 1 maturity would be a fairly good sized maturity, and July 1 is one of the largest maturity dates we have for interest coupons.

Mr. Palmer: I didn't hear the Court's question.

The Court: I want to know who has been clipping those coupons on the securities that are in West Virginia. He said nobody.

Mr. T. C. Townsend: Since June 6th.

Mr. Palmer: In relation to that I got in touch with the trustee personally at the request of the Auditor to ask if the trustee could furnish someone to aid the Auditor in doing that. There was no one employed by the Auditor or the State Treasurer whose services could be spared for that. The trustee said they couldn't spare anyone to help do that, and they didn't feel that they should; so that is one of the [fol. 1170] reasons why it has not been done. The trustee said they did not feel that they could spare any one of their employees to aid in that work.

The Court: Mr. Townsend, do you know anything about that, as to the clipping of the coupons?

Mr. T. C. Townsend: Yes sir, we know something about it, and I would like for the trustee to make his own statement, if the Court will permit it, about the efforts he has made to have the coupons clipped.

The Court: I would like to have that done.

Mr. T. C. Townsend: Go ahead, Mr. Dickinson.

Mr. John L. Dickinson: We notified the Auditor, and sent a copy to the Treasurer, of the coupons that were due as well as the bonds that were due and unpaid. As I recall it, the Treasurer advised us that he had nobody in his office

who could cut them, and wanted us to do it. We didn't object particularly to doing it, and would have done it, but they had the securities locked up jointly with us and we didn't have the privilege of going into the vault to get them without them, and they have steadfastly refused to do anything further. There is now, I think, a question up, if the bonds that are matured and the coupons that are matured [fol. 1171] are collectible, as to whether that particular fund would go to the Treasurer or the Auditor of the State, whoever should get the bonds, free of any connection with the trustee, our position being that inasmuch as this box was held by Fidelity and then the trustee—Fidelity jointly with the State—certainly the trustee then superseded Fidelity and likewise had that same right as to whether or not the funds derived should be held jointly by the two. That has occurred quite recently, so recently that neither the trustee nor the counsel for the trustee have had the opportunity to discuss with the Court just what we should do. We are entirely willing to furnish a man to help them cut the coupons. I think we are just about as busy as they are. We didn't want to go down ourselves and cut the coupons.

The Court: Well, the coupons ought to be cut, it seems to me, and then the cash derived from the coupons ought to be put in the same status as the securities themselves. Later it can be determined what to do with it.

Mr. Dickinson: The difficulty, Your Honor, is when those coupons are cut or the bonds mature, when they are turned over to whoever collects them that is immediate cash, and so regarded, and then the question of where the funds go [fol. 1172] arises, and whether it should be held by the trustee jointly with the State, or whether it should be turned over to the State.

The Court: Is there any reason why the cash should not be put in the vault?

Mr. Dickinson: Held jointly by the two?

The Court: Yes.

Mr. Dickinson: We have made that suggestion, but I think we have not had a reply. I have been out of the city for a few days and am not right up to date on it.

The Court: What would be the objection, Mr. Palmer, to cutting the coupons and collecting on them and then having the proceeds in the same status that the securities now have?

Mr. Palmer: I can't see any, Your Honor. I talked to Mr. Dickinson personally on the phone some little time ago at Mr. Sims' request and asked that some one of the trustee's force be authorized to aid Mr. Sims in the clipping, and Mr. Dickinson at that time informed me that the trustee didn't have a person that they could spare and didn't feel they should; it was up to Mr. Sims.

The Court: You two get together on that and get these [fol. 1173] coupons clipped.

Mr. Dickinson: There is no trouble about getting together. I think you are mistaken, Mr. Palmer: I think you talked with Mr. Payne. If you say you talked to me, I will accept your statement.

Mr. Palmer: I wouldn't want to be sure either.

Mr. Dickinson: The substance was that the treasurer wanted somebody to cut all of his coupons, without him helping at all, as he was very short of men. We were very short at the time ourselves.

Mr. Palmer: I can't see, unless Mr. Sims can, why they can't be clipped and the cash put right in the vault in the place of the coupons.

Mr. Edgar B. Sims: I have already authorized the Treasurer, Mr. Talbot, to clip the coupons and obtain the cash and to retain the custody of the cash for the use and benefit of the contract holders. Likewise I have instructed him to sell certain bonds that have been called and take the cash and retain possession of it for the use and benefit of the contract holders.

The Court: Well, what you mean by that is just to leave it at the same place that the securities are, don't you?

[fol. 1174] Mr. Sims: I believe under the law I can tell the Treasurer now he shall keep it. I told him to retain it.

The Court: All right. Anyhow, somebody get those coupons cashed.

* * * * * * * *

[fol. 1175] Q. In other words, the highest that the assets ever were between April 10th and June 6th, 1941 was this $23,000,000 figure that appears on your schedule as of June 6th?

A. I would be safe in saying that that would be the highest figure.

Q. You have testified with respect to the West Virginia state receivership. Who were the people who would be the

beneficiaries of that receivership? Who had an interest in the proceedings? Was it just the West Virginia contract holders, or was it others?

A. Well, of course, the notion was that as state court receivers we would attempt to reorganize or manage the assets of the company in a way that would be beneficial to all the contract holders everywhere.

Q. Whether they were West Virginia residents or residents of other states?

A. Well, that would have been our intention, yes.

Q. Do you know anything about the rights of contract holders in or outside of West Virginia with respect to sharing in the West Virginia deposit?

A. Yes, I know that in states where deposits were not [fol. 1176] maintained or were maintained in an amount less than the liabilities for that state, that those securities were on deposit with the State Treasurer of West Virginia. Did I answer your question? Maybe I didn't.

Q. Out of the twenty-nine states which contained people who held contracts of this debtor, in how many of those states, if you know, were the deposits sufficient to satisfy the total cash liabilities?

A. I could refer to the records. Off hand, I do know that Wisconsin was fully covered. I say by that that the value of their assets equalled the liabilities to contract holders. And the State of Iowa—I can't answer that, Mr. Reinhardt from memory. I can refer to the—but there is no more than two or three states wherein the deposits were equal to the amount of liabilities.

Q. Would it be fair to say that in at least twenty-five of the twenty-nine states there were either no deposits or a deficiency of deposits?

A. I think that would be a safe statement.

Q. And according to your understanding, contract holders in each of those twenty-five states would be entitled to look to the West Virginia deposits for satisfaction in all of [fol. 1177] their obligations?

A. That is my understanding.

Q. Mr. Smith, you testified as to a deficiency in the general fund. Does that reflect the fact that the total assets of this debtor were of a value less than its total cash liabilies?

A. No, my statement with regard—I was treating the general fund separately. I wasn't trying to group the over

all assets and liabilities of the company, including the contract funds.

Q. Will you address yourself to that other question that you didn't cover before and indicate whether on the basis of your knowledge you can say that the liabilities of this debtor, the cash liabilities, exceeded the market value of its assets on June 6th, 1941?

A. You mean as a whole now, the contract funds—the total of the contract funds and the general fund? The liabilities were greater than the market value of the assets on June 6th.

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[fol. 1178] J. H. SCHELLHASE, recalled as a witness on behalf of the debtor, testified as follows:

Direct examination.

By Mr. Fleming:

Q. You may state your name to the Court, please.

A. Harold Schellhase.

Q. You are the same Mr. Schellhase who has testified heretofore in this case, are you?

A. I am.

Q. You have been employed by Fidelity for some period of time, have you?

A. Yes sir.

Q. For how long?

A. Approximately sixteen years.

Q. What is your present position?

A. Statistician.

Q. How long have you been so employed?

A. As statistician about a year and a half.

Q. What did you do prior to that?

A. I worked on the accounting, making statements.

Q. That is, for the past seventeen years the greater por-
[fol. 1179] tion of the time you have been in the accounting department?

A. Yes.

Q. And as statistician you are still in that same department, aren't you?

A. I have access to the accounting department.

Q. When you first came with Fidelity these income contracts were being sold by Fidelity, at that time, weren't they?

A. The annuity contracts?

Q. The annuity contracts.

A. Yes sir.

Q. Was there a contract preceding that, a special income contract?

A. Special income.

Q. That came before the annuity contract?

A. Yes sir.

Q. As these contracts were sold, and as the funds derived from the sale of these contracts came into the company, when you first came in how were those funds handled from an accounting and bookkeeping viewpoint?

A. Of course, at that time, when I came into Fidelity [fol. 1180] I came in as a messenger.

Q. You did?

A. Yes, sir. But it is my recollection that the income fund was kept separately from the annuity fund.

Q. Then later the Class A contract was created, wasn't it?

A. Yes, sir.

Q. And then later Class B contract fund was created?

A. Yes.

Q. Then later Class C and D were created?

A. Yes, sir.

Q. While you were with the company were those contract funds kept separate as a bookkeeping transaction?

A. Yes, sir.

Q. On the books of the company?

A. Yes, sir.

Q. When securities were purchased by the use of those funds—that is, from those funds—how would those securities be handled from a bookkeeping viewpoint?

A. Well, they would be purchased for the fund from whence the money came.

Q. Did you have a complete record of all monies re- [fol. 1181] ceived by the company from each contract fund and a record of all securities purchased by the company from the monies from each contract fund?

A. Each security was earmarked for what fund it was purchased for.

Q. Did you have a description of each security that was purchased?

A. Oh, yes.

Q. And that was allocated at the time it was purchased to the particular contract fund?

A. That is right, yes, sir.

Q. As securities were deposited in the various states with the state officials under the state laws, did you have a record of what fund those securities belonged to?

A. We always had a record of what fund——

Q. And, for instance, in Wisconsin you know how many securities they have that belong to the special income fund?

A. Oh, yes.

Q. The special annuity fund?

A. Yes.

Q. The Class A contract fund?

A. Yes.

[fol. 1182] Q. The Class B contract fund?

A. Yes, sir.

Q. The Class C?

A. Yes.

Q. And the Class D?

A. Yes.

Q. Have you made a compilation for the purpose of showing from the records of the company the status in each state of the securities on deposit in that state and particularly in reference to what contract fund those securities belonged to?

A. We have such a record.

Q. You have?

A. Yes.

Q. Do you have a memorandum of the compilation with you?

A. On some particular states.

Q. What states have you?

A. One for Illinois, Maryland, Missouri, Ohio, Tennessee and Wisconsin.

Q. Could you make that compilation for all of the states in which securities are deposited?

[fol. 1183] A. Yes, we could. That was prepared jointly by Mr. C. E. Smith and myself.

Debtor's Exhibits 50 to 55, inclusive, Six papers which were produced by the witness were marked for identification, at the request of Mr. Fleming, as above indicated.

Q. I hand you debtor's Exhibit 50, which you may examine and tell the Court, if you will, what that is.

A. It is a statement of the State of Illinois on securities held—market values of securities held June 6th 1941 as

against net cash liability as of April 10th, 1941 by contract funds.

Q. Will you just explain to the Court, if you will, in reference to those contract funds, what they show in the State of Illinois at the time that compilation was made?

A. You mean read these?

Q. Yes.

A. The income fund has no securities on deposit, with a cash liability of $160,707.29. The annuity fund has securities on deposit of $254,633.75, with a net cash liability of $645,388.18. Annuity maturity and retirement fund, securities $257,413.75, with a net cash liability of $533,232.16. [fol. 1184] The Series A fund, securities, $505,316.50, and net cash liability of $533,110.28. Series A Maturity and Retirement Fund has no securities on deposit but has a cash liability of $20,227.79. The Series B fund has securities on deposit of $2,488,515.00, with a net cash liability of $2,096,356.29. The Series B Maturity and Retirement Fund has securities of $254,015.00 with net cash liability of $231,072.15. The Series C fund has no securities and no liabilities. The Series D fund has no securities, with a liability of $5,696.61. The Series D maturity and Retirement Fund has no securities and no liabilities. The general fund has no securities and no liabilities. The total securities equal $3,759,894.00, and total net cash liability is $4,225,790.75.

Q. I hand you debtor's Exhibit 51, which you may examine and state to the Court what that represents?

A. It represents the securities on deposit and the net cash liability for the State of Maryland.

Q. And that was made upon the same basis as you made it for the State of Illinois?

A. That is right.

Q. I now hand you debtor's Exhibit 52, which you may [fols. 1185-1195] explain to the Court, if you will, please.

A. That is the State of Missouri securities on deposit and net cash liability.

Q. On the same basis as Illinois?

A. Yes, sir.

Q. I now hand you debtor's Exhibit 53, which you may explain to the Court.

A. For the State of Ohio, securities on deposit and net cash liability.

Q. I now hand you debtor's Exhibit 54, which you may examine and explain to the Court, if you will.

A. The State of Tennessee, securities on deposit and net cash liability, the same as Illinois.

Q. I also hand you debtor's Exhibit 55, which you may examine and explain to the Court, if you will, please.

A. State of Wisconsin, securities on deposit and net cash liability, the same as Illinois.

Mr. Fleming: Would you like to examine these? I will make my offer and then you can examine them. Debtor now offers to introduce and read in evidence debtor's Exhibits 50 to 55, both inclusive.

. . . . . .

[fol. 1196] By Mr. Huwe:

Q. You were on the stand and testified for a short time at the last session, weren't you? At that time, if you will recall, you stated that the cash payments that came into the various contracts, especially special income, special annuity, Series A and the cash of the general fund was carried as one cash account in the bank?

A. Prior to 1938.

Q. Prior to 1938?

A. Around that time.

[fol. 1197] Q. And you discontinued that practice after the injunction of 1938?

A. Yes, sir.

Q. What was your practice prior to 1938 with reference to B, C and D contracts?

A. They had a separate bank account.

Q. So that the cash payments from the contract holders in those three accounts always were kept separately in the bank, as well as everywhere else?

A. That is right.

Q. With respect to all of those different series of contracts after 1938, after the injunction, and during '39 and '40——

A. They each had separate bank accounts.

Q. Each had separate cash accounts?

A. Yes.

Q. So that there was at no time any commingling of cash of one fund with that of another after December, 1938?

A. That is correct.

The Court: What do you refer to when you say "after the injunction"?

Mr. Huwe: By "injunction" I presume we both mean the [fols. 1198-1211] injunction proceedings in the eastern district of Michigan at Detroit, brought by the SEC in December, 1938.

. . . . . .

[fol. 1212] By Mr. Reinhardt:

Q. Mr. Schellhase, are you familiar with the bookkeeping that occurred when a contract in a particular state matured and was paid off? I say, are you familiar with the bookkeeping that occurred at that time and in that connection?

A. I know what happens.

Q. Will you describe briefly what happens on the company's books when a contract matures and is paid off in a state in which the company has a deposit?

A. Well, of course, the company pays out of cash.

Q. Will you take a particular contract in a particular series and tell us what cash they use, where the cash comes from and so on.

[fol. 1213] A. Of course, a contract of the Series B or Series A fund at the time the last payment on the contract is transferred to the maturity and retirement fund by cash; and, of course, that cash is invested the same as the regular contract fund for the payments that are coming in on it. Then when a contract matures, of course, there is usually cash on hand to take care of maturity or to pay out the amount of the maturity settlement.

Q. That cash would be in a bank account belonging to that particular fund?

A. That is right since 1938.

Q. The cash would be withdrawn from the bank account belonging to the fund allocable to that series of contracts?

A. That is right.

Q. And would be withdrawn from that account and paid to the contract holder?

A. That is right.

Q. Now, how would that be reflected in the deposit made in the contract holder's state?

A. Of course, the liability after the contract has matured and went out—the liability, of course, was not there; the state would be reduced by that much.

[fol. 1214] The Court: The liability would, but what about the security?

Mr. Reinhardt:

Q. What about the deposited security?

A. Well, of course, for one particular contract there probably would not be anything done about it. Of course, if the liability decreased so much so that you would have a big deposit up there with no liability, we would ask to have some of it withdrawn.

Q. Did that ever occur?

A. Well, I think in 1939 it did occur, when the surrenders were very heavy there in the first part of '39. I am not so familiar with that. The securities department can answer that better than I on the withdrawal of the securities, whether we actually did withdraw it.

Q. Suppose a contract matured but the money was not paid out immediately. Suppose that contract holder elected to receive installment payments. How would that be reflected in the treatment of the securities on deposit in the contract holder's state?

A. It would have the same effect as paying the full amount due. What I mean by that is that you would always reflect the decreasing liability for that particular contract.

[fol. 1215] Q. You would reflect it only to the extent that cash payments actually were made out?

A. That is right.

Q. And it was not until the liability on that series of contracts in that particular state was substantially below the deposited amount that a request would be made by the company for the withdrawal of deposited securities?

A. Well, I don't know—the only time that I recall—and I am not certain about it—is that the only time we requested the states to take down some of those securities was in 1939. Most of the time I would say those securities were held out there for the increasing number of payments probably of some other contract fund, so that the deposit was maintained at all times either by that particular contract fund or by another fund's securities.

The Court: Let me ask you this. There were a number of funds shown on your own book, but your deposit in the state was just one deposit, wasn't it, and not separated into funds?

A. I think that is—I don't know for sure about that, but [fol. 1216] I think it was just one deposit in a state.

Q. Then, even if one fund did accumulate a surplus in a state, if some other fund was short, you couldn't get back any money from the fund that had a surplus, could you?

A. No, unless we would put up securities of the same value in the fund that was short.

The Court: Go ahead.

Mr. Reinhardt:

Q. Are you personally familiar with the deposit and withdrawal of securities in the state depositories?

A. I am not.

Mr. Reinhardt: Then I won't continue this examination. Who is?

A. I would say Mr. C. E. Smith and Mr. Hubert Young.

Q. In response to one of these later questions, you said that a security that was on deposit with a state that had originally been deposited to secure a particular contract in a particular series would remain when that contract matured and might remain to secure a contract of another series. Did you mean that, or do you mean that it might remain to secure a contract of that same series, but not [fol. 1217] the same contract?

A. Well, it may mean both ways. It could be there to secure the contract of the same series or of another series, if the deposit is needed.

The Court: It depends on which one was short, doesn't it?

A. Yes.

Mr. Reinhardt:

Q. Do you know of your knowledge whether either or both of those situations actually did occur?

A. I would say that probably both of them have occurred.

Q. Your answer would apply to cash surrenders as well as to maturities of contracts?

A. That is correct.

C. E. SMITH, called as a witness on behalf of the debtor, having been duly sworn, testified as follows:

[fol. 1218] Direct examination.

By Mr. Fleming:

Q. State your name to the Court, please, Mr. Smith.
A. C. E. Smith.
Q. Where do you live?
A. Brookside, Bridgeport, Ohio.
Q. Is that near Wheeling?
A. About two miles from Wheeling, yes.
Q. Have you been employed with Fidelity for some time?
A. Since July 1st, 1917.
Q. You have been with Fidelity ever since?
A. Yes.
Q. Still with them?
A. Yes.
Q. What was the character of your original employment with Fidelity?
A. Started as a messenger and addressograph operator.
Q. What have you been in recent years?
A. Assistant secretary.
Q. What other capacity?
A. For a short time in 1940 up to, I believe, March of this year I was a director.

[fol. 1219] Mr. Palmer: Will you speak just a little louder, please?

The Witness: I say for a part of 1940 and I believe up till March of 1941, at the annual meeting, I was a director.

Mr. Fleming:

Q. What have been your duties in recent years, Mr. Smith?
A. In recent years I have been in charge of the security records, that is, the recording of the security transactions as to the commitments that have been filled.
Q. And in that capacity did you have to do with the handling of securities of Fidelity?
A. Not the physical handling of securities to any great extent. That was limited to such securities as may be in our own vaults at Wheeling and such securities as might be sent down from New York to Charleston or shipped from Charleston to New York.

Q. Did you have anything to do with the handling or procuring of the income from the security portfolio of Fidelity?

A. Yes, that was part of my duties to take care of the collection of the income.

[fol. 1220] Q. Who received the income from the security portfolio while you were working for Fidelity?

A. The major portion of it was sent to us at Wheeling by registered mail coming from the various depositories.

Q. That is in the various states?

A. Yes, and those securities which were in New York in our own—I should say in banks acting as our safe keeping agents, they would usually cut the coupons, collect them, and credit our account with the proceeds, which were then duly credited upon our records upon the advice of the collecting bank.

Q. How was that handled here in Charleston and West Virginia?

A. In Charleston the State Treasurer's deputies would clip the coupons from securities on deposit with the state and deliver them to me and I, in turn, would mail them to Wheeling, and from that point they would go through our records as deposited in a bank.

Q. That is, you would come to Charleston?

Mr. Palmer: If Your Honor please, I can't hear either the witness or Mr. Fleming. I am sorry. I think it is the outside noises.

[fol. 1221] The Court: Both of you try to talk a little louder.

Mr. Fleming:

Q. Then, as I understand, you would come to Charleston and contact the State Treasurer and you would go to the bank in which the securities were kept?

A. That is right.

Q. And the Treasurer or his assistant or deputy would clip the coupons and deliver them to you?

A. That is right.

Q. During any of the period you were with Fidelity, did you ever have any securities deposited with the Auditor of State belonging to Fidelity?

A. Deposited with the Auditor?

Q. Yes.

A. In West Virginia our deposits were made with the approval of the Auditor, but custody of the securities was

with the State Treasurer. In other words, the State Treasurer would not accept for deposit or deliver securities to us from our deposit unless such transactions were approved by the State Auditor.

Q. Who purchased, or who had to do with the purchase of securities, say for the past nine or ten years, for Fi-
[fol. 1222] delity?

A. Well, the routine, or rather the practice followed there was that our investment department in New York would make recommendations for the purchases or sales of securities to our investment committee. The investment committee, acting upon these recommendations, would either approve or disapprove the recommendations. Now, on approval of a recommendation for purchase or sale, Mr. Young, who was in charge of our investment department in New York, would make the commitments.

Q. That is, he would act as the representative of Fidelity in making the purchases of securities?

A. Yes.

Q. Just explain to the Court how those——

A. Pardon me, Mr. Fleming; I just recalled that you said the last nine years.

Q. Yes.

A. I want to amend that, because Mr. Young, I believe, came with us in 1932. Well, that is nine years, approximately, so that stands as I stated it.

Q. Just explain in detail to the Court how these transactions were handled, Mr. Smith, please.

[fol. 1223] A. Mr. Young, on receiving the approval of the investment committee for a given transaction, would then make a commitment with the bond houses or brokerage firms and would then instruct their bank in New York to accept the bonds purchased against payments, or deliver bonds sold against payments. Upon completion of that transaction, the bank would advise, giving us the necessary details. We would prepare our records at Wheeling from that, using this advice from Mr. Young as to what he had bought for comparative purposes and checking purposes. The bank would return the bonds purchased in its own safe keeping vault for our various accounts, and from that point they would move to the various depositories in accordance with instructions given them by Mr. Young.

Q. And Mr. Young would act on instructions given him by you, or by some other representative?

A. No, he would be advised by Wheeling—I should say in the case of a deposit to cover a liability he would be governed by reports received from Wheeling as to the liability in a given state. Deposits made as replacements for securities to be withdrawn from a particular depository—well, he would be governed on that by his particular [fol. 1224] need for selling a security. By that I mean if it was advisable to sell certain of our securities on deposit in a state, he would buy other securities and ship them to the state involved against the withdrawal of the securities which he wanted.

Q. How many classes of contracts have been sold by Fidelity since you have been with the company, Mr. Smith?

A. Well, there was—the old ten year series.

Q. Was that special income?

A. That was the original series, and I believe it has been completely paid out. Then there was a Series C—the Series C and the income contract, the annuity contract, the Series B contract and the Series D contract.

Q. Series A?

A. And Series A, yes, sir.

Q. You have been with the company during the period when all of these contracts were sold?

A. That is right.

Q. In fact, you came with the company shortly after it was founded, did you not?

A. Well, about six years after it was founded.

Q. As these contracts would be sold, the money would [fol. 1225] come into the company, would it not?

A. That is right.

Q. And would it be allocated upon the books of the company to the contract fund from which the money was received?

A. Yes. All of the funds derived from a given class of contract holders were so earmarked. In other words, separate accounts were kept as to each series of contracts.

Q. In other words, as contracts would be sold the money would come in and would be earmarked to that particular fund, would it not?

A. Yes.

Q. Then those funds would be taken and invested in securities and the specific securities earmarked and or-

dered of record to the credit of that fund on the books of the company?

A. Yes, that is right.

Q. After that occurred, then the securities would start flowing into these various states where the contract was being sold for deposit with the state officials?

A. *Yes.*

[fol. 1226] Q. Explain those transactions to the Court, if you will, please.

A. In just what way, Mr. Fleming?

Q. Just how that was done—how the securities were deposited.

A. Desiring to deposit a block of securities with a state department, Mr. Young would write to the official in charge asking for approval of the particular security, and upon receiving that approval, he would give instructions to the bank in New York to forward those securities by registered mail, of course, to that state authority or that authority's agent. In some cases securities were deposited with a bank acting as trustee for a state. As an example, the deposit of the State of Missouri was in the custody of the Wheeling Dollar Savings and Trust Company at Wheeling, which was acting as the agent for the State of Missouri.

Q. You had the same situation in Tennessee, did you not?

A. Yes, Tennessee and in Virginia and Indiana.

Q. And probably Alabama?

A. And Alabama.

[fol. 1227] Q. When these securities were deposited with the various state officials, was any effort made to allocate or segregate those securities and keep them separated in the fund or for the benefit of the fund to which they belonged?

A. I received copies of all the correspondence that Mr. Young had with these various state departments; it was necessary that I have copies so as to know what was being done and so that our records could be made to conform to those instructions or conditions; and I do recall that in the case of one state a request was made to segregate the securities belonging to the Series B account, and if I remember correctly we were advised that such segregation could not be had because of the detail in maintaining records of that type.

Mr. Lauritzen: May we have that last answer again? I just couldn't hear that.

A. I say I did receive copies of all letters that Mr. Young wrote to the various state departments—in fact, all letters that he wrote to state departments and to banks dealing with the placement of these securities. If I recall correctly, [fol. 1228] I do recall seeing a copy of a letter written by Mr. Young to one of the states asking him to segregate the securities belonging to the Series B account, and I understand—in fact, I think there is a letter in our file wherein that state answers that they could not make that segregation because of the detail involved.

Mr. Lauritzen: The state answered, or Mr. Young answered?

The Witness: The state.

Mr. Fleming:

Q. What state was that?

A. I believe that was Illinois; I am not sure.

Mr. Fleming: We have that letter on file, I think.

Q. Did you have anything to do with assisting in procuring licenses to sell contracts in any states?

A. No, that didn't come within my department.

Q. Who handled that?

A. That, I believe, came under Mr. McNulty's direction. Of course, on that, if an application for a license to do business involved anything in the way of securities, reports we would naturally supply them or make them up.

Q. Do you know whether or not copies of the contracts [fols. 1229-1231] that were sold in the respective states were deposited prior to their sale with the proper state officials of that state?

A. Now, as to that, I can't answer for each state, but I am quite sure that copies of contracts were filed with at least most of the states before license was granted to do business. I believe that was a necessary requirement or a requirement necessary to obtaining a license.

Q. And those contracts remained on file during the period of the license?

A. I have every reason to believe that they did, yes.

. . . . . .

[fol. 1232] Q. Did you have any contract of any kind or any other signing or memorandum in writing in reference

to where these securities were to be deposited or how they were to be deposited during that period?

A. I don't think so. At least I have never seen a contract to that effect.

Debtor's Exhibit 58

At Mr. Fleming's request a paper was marked for identification as above indicated.

Q. I hand you here a paper marked Debtor's Exhibit 58, which you may examine, and I will ask you whether or not you have ever seen the original of which this is a copy in the files of Fidelity.

A. No, I don't recall seeing a copy of this, but this is in accordance with my understanding of the arrangement down here. In fact, all of my dealings down here have been on this basis. That is, the custody to the boxes was—could only be had in the presence of—well, in the presence of the [fol. 1233] State Treasurer or one of his deputies or two deputies of the State Treasurer and a representative of Fidelity, which might be myself or someone else delegated to that job, and a representative of the Central Trust Company.

Mr. Palmer: May I see that paper?

Mr. Fleming: Yes. (Handing it to him.)

Q. In other words, Mr. Smith, neither Fidelity nor the State Treasurer had control or custody over this property, but the control and custody was jointly in Fidelity and the State Treasurer, wasn't it?

Mr. Palmer: I object to that question, Your Honor. The state laws of West Virginia provide for that, and it is not a question of fact for this witness to testify to; it is entirely decided by the statutes of West Virginia and the legal interpretation thereof.

The Court: The state law might provide how it ought to be done, but if it was done in some other way the fact that the law says it ought to be done in that way would not change the facts. I overrule the objection.

Mr. Palmer: Read the question, please.

(The question was read.)

[fol. 1234] Mr. Palmer: My objection, Your Honor, is to the words "custody and control."

The Court: I will sustain it as to control, but not as to custody. Custody is a physical fact.

Mr. Fleming: I will strike out the word "control."

A. I feel that custody was in the State Treasurer, in that we had no voice——

The Court: Now, if the witness is going to answer the question this way I will have to sustain the objection altogether. I presumed he would answer as a matter of fact. It is not a question as to who he believes had it.

The Witness: May I change my answer?

The Court: Well, go ahead, if you know the fact.

A. Well, the custody was with the State Treasurer.

Mr. Fleming:

Q. But, as I understand, in order to obtain access or exercise that custody, Fidelity had to be present. Is that right?

A. That is true.

Mr. Palmer: I object to that, Your Honor. That is, again, a question of state law as to whether anyone had to be present or not. They may, as a matter of fact, have been present, but it is a question of state law as to whether any- [fol. 1235] one had to be present when the state officers exercised their control.

The Court: I will sustain the objection. I would like to ask a question or two myself.

Q. Who had keys to the safe deposit vault?

A. The State Treasurer.

Q. Anybody else?

A. No. No, there was a set of keys, a duplicate set, and those sets——

Mr. Townsend: I can't hear you.

A. I say the State Treasurer had the keys to the safe deposit chest. There were two bunches of keys, one a duplicate set, and both sets were in the custody of the State Treasurer.

The Court: Who paid for the deposit box?

A. Fidelity.

Q. In whose name was it carried on the books of the Central Trust Company, if you know, as the owner?

A. They were carried in the name of Fidelity.

The Court: All right. I just wanted to get those facts. Now you may go ahead.

Mr. Fleming:

[fol. 1236] Q. I will ask you whether or not under your agreement with the Central Trust Company it was possible for the Treasurer to obtain access to the box holding these securities without the presence of Fidelity?

A. No, it was not.

Q. Explain that to the Court.

A. That was—that was the arrangement made in the letter which you just gave me, in that the boxes were rented in our name.

Q. And you paid the rental on the deposit box, I understand?

A. We paid the rental, and while the boxes were in our name, we couldn't have access to them, neither could the Treasurer, unless both parties were present, and then—access was contingent upon a representative of the bank, naturaliy the custodian of the pass key.

The Court: As I understand, that was an agreement between Fidelity and the State Treasurer?

A. That was the instructions that came in the letter which they just passed here, making arrangements for the rental of these boxes.

The Court: I have not seen that letter, nor has it been [fol. 1237] introduced.

Mr. Fleming: I wonder where the original is. This seems to be a copy. You don't know where the original of this letter is, do you?

A. No, I don't.

Mr. Fleming: I understand Mr. Isaiah Smith has or can procure the original. I think that copy, Your Honor, was prepared by Mr. Smith from the original.

The Court: Any objection to introducing this?

Mr. Palmer: No objection that it is only a copy, but our objection to it is this, Your Honor, that regardless of whether the original was made by Mr. Johnson, then State Treasurer, no such agreement could be made by an official of the State of West Virginia which would bind any suc-

cessor of his, particularly in view of the state law, if these funds were deposited in accordance with the statute of the State of West Virginia, that the State of West Virginia and the Treasurer as custodian thereof, it didn't require any official of Fidelity or any bank to be present when the Treasurer undertook his custody, and no Treasurer had the right to enter into any such agreement. Now, for the [fol. 1238] practical end of it, in order for all of the parties to feel perfectly safe in it and the Treasurer to feel perfectly safe, he may have wanted other parties up there at any time he examined it, either Fidelity, Central Trust, or any outsider, so there could never be any accusation of anything wrong; but the agreement itself is entirely illegal, in that the statute of West Virginia is the only thing that can be binding.

The Court: I understand your argument on the point, but as to the reception of this letter for such bearing as it may have, you have no objection to the fact that it is a copy and not the original?

Mr. Palmer: None at all, Your Honor.

Mr. Fleming: We can substitute the original, if it is desired.

Mr. Palmer: We have no objection to its being a copy.

Mr. Huwe: I think it is common knowledge that where you have a statute you certainly are allowed to prove the terminology, and then, in addition, you are allowed to prove the administrative practice with respect to the administration of that statute. What the state offices did with [fol. 1239] respect to the administration of those positions is competent; and therefore any agreement, any request that a third party be present, or anything of that sort which is demanded or required by a state officer, is certainly competent evidence, and I think some of the things this man has testified to in that respect are competent under those circumstances. You are allowed to prove the administrative practice of the administrative officers trying to apply the conditions of the statute.

Mr. Fleming: This is offered on that theory, Your Honor, and I want to see if this arrangement was followed as outlined in that letter up to the time of the appointment of the receivers on April 10th.

Mr. Palmer: Perhaps Mr. Huwe doesn't realize that the letter purporting to be an agreement was signed by one Mr. Johnson, who was State Treasurer in 1929, and I don't

see how Mr. Huwe could argue, under his theory, that that is binding on Mr. Talbot, the present State Treasurer.

The Court: Mr. Fleming has just said that he proposes to follow this up by showing that the practice was followed [fols. 1240-1265] right up to the appointment of the receiver.

Mr. Palmer: We have no objection to showing what happened. Our objection is that no agreement made by Mr. Johnson would be binding, because the state statute provides for the custody and control.

The Court: I understand your objection on that. I will permit it to be introduced in evidence and marked.

Debtor's Exhibit 58

The paper referred to, which had previously been marked as above indicated, was admitted in evidence. The same is attached hereto as a part hereof.

Mr. Fleming: I will ask you whether or not this same arrangement as contemplated in debtor's Exhibit 58, which you have just examined, was continued during the entire period concerning which you have testified, and particularly up to April 10th, 1941?

A. Yes, that was the arrangement under which the deposit was handled.

. . . . . .

[fol. 1266] By Mr. Lauritzen:

Q. Mr. Smith, I believe you testified that you were familiar with and received copies of letters that Mr. Young wrote when he transmitted securities out to the various states?

A. Yes, sir.

Q. Would you examine these letters, which appear to be letters addressed to the Banking Commissioner of Wisconsin, signed Fidelity Assurance Association by Hubert F. Young, and tell me whether those are such letters?

A. Yes.

Q. And are those typical of letters that Mr. Young wrote out at other times to the Banking Commissioner of Wisconsin and also to other state officials having charge of Fidelity's deposits?

[fol. 1267] Mr. Fleming: To this the debtor objects.

The Court: I don't believe I can rule on that without seeing the letters.

(Witness hands papers to Court.)

The Court: Are these letters being used for the purpose of showing that there was no designation made by Fidelity of any particular fund in which the securities were to be deposited?

Mr. Lauritzen: That is the purpose, Your Honor.

The Court: I overrule the objection.

Mr. Lauritzen: I don't want to encumber the record with these letters, Mr. Smith, but they run from January 11th, 1939, and the latest one is March 24th, 1941. There happen to be eight of those letters here, and as I read the letters they address the Banking Commissioner and then state "Complying with your request" of such and such a date they are forwarding certain securities and then they tell what the securities are and in what amount?

A. Yes.

Q. And are those the kind of letters that Mr. Young generally sent out to these various state authorities?

Mr. Flemin-: Mr. Young would be the best witness to [fol. 1268] that.

The Court: Well, this witness says he knows about it. I will let him answer.

A. I think they are—they are fairly typical of the letters that go out.

Mr. Lauritzen: It is a fact, isn't it, Mr. Smith, that though you had on your books separate accountings for various funds, as you testified, that when you complied with state laws in making deposits in those states there was no segregation made in this deposit in respect to various series of contracts, was there?

A. In the case of the State of West Virginia our deposit schedule indicated the fund to which the security deposited or withdrawn really belonged.

Q. By "deposit schedule" what do you mean?

A. Whenever we made a deposit or withdrawal from the State of West Virginia we prepared a schedule—this dates back to approximately 1933—we made a schedule showing the par value, the name and description of the security, the interest rate and date and the maturity and the market value, the fund to which it belonged.

Q. Then the letters that you sent to the State of West [fol. 1269] Virginia transmitting funds were somewhat different from these letters? Is that correct?

A. You see letters would not go to the State of West Virginia, since that deposit was handled differently than the deposits in other states. In other words, the only letters written—that is, generally speaking—pertaining to West Virginia would be letters which Mr. Young would write to me informing me that he was making certain shipments from New York and would I deposit those in West Virginia, and in turn ship to him certain securities which he wished to withdraw. I would take care of preparing the schedules and coming to Charleston would present that schedule to the state officers.

Q. Do you have any of those schedules with you?

A. I do not have any with me, no.

Q. And you say that practice was followed since 1933?

A. Yes, approximately.

Q. Do you know what the purpose was in giving more information on those schedules that you filed with West Virginia than you gave on letters to the other states, including these written to Wisconsin?

A. That was made at the request of the Securities Com- [fol. 1270] missioner and the State Auditor's office.

Q. Do you know whether or not the securities you had on deposit in West Virginia actually covered, fund by fund, the contract liabilities which those securities were securing?

A. No, I don't have enough information on that. The calculation of the liability on the funds would not come within my department, and my concern would be purely with the value of the securities.

Q. Do you know whether, with respect to the State of West Virginia or any other state, Fidelity ever undertook to have on deposit in West Virginia or any other state securities, fund by fund, back of contracts fund by fund?

A. Well, that situation doesn't exist in all states. In other words, there are some deposits, or there are states in which contract deposits are in excess of requirements and where deposits to other series are less than requirements.

Q. And isn't that true in West Virginia?

A. That would all depend on how it was being calculated. If you are speaking only of West Virginia liability——

[fol. 1271] Q. No, I mean the whole West Virginia deposit. The law required that you lay down a deposit here for all contract holders everywhere, if you will recall?

A. Except that we would be given credit for deposits made in other states, that is, where the deposits were required by law in other states.

Q. Yes, sir.

A. No, I don't know what the comparison is between the value of securities and the liability. I am not familiar with the liability figures.

Q. Well, generally speaking, in most every state that had a deposit there was no segregation of funds there against any particular contract series, was there? You know that of your own knowledge.

A. No, that is just what I said earlier, that some states—one state in particular advised us that they could not maintain separate records.

Q. You mean that you had asked that state to maintain separate records?

A. Yes, I believe every state was asked to separate the—I am speaking now—to separate the securities of Series B from those held for other accounts. That was in ac-
[fol. 1272] cordance with the indenture contract itself.

Q. Will you get me one letter where you asked a state to do that? Can you find that for us.

A. I will try to. I don't know whether that letter is in Wheeling or whether it is in New York.

Q. Mr. Smith, what would be the point of Fidelity asking the states to make a segregation when the state doesn't know where the securities come from? You just send them out a batch of securities and you presumably have the information on your books as to what fund the securities came from.

A. I would come back to the State of West Virginia and answer it this way, that in making up the schedules of securities deposited or withdrawn, we indicate the fund to which those securities belong, and in the case of the physical securities themselves, securities belonging to the income contract account, the annuity contract account and the income reserve Series A account are filed in a chest separate and apart from those belonging to Series B and separate from Series D. In other words, securities belonging to Series B account and the securities belonging to Series D account are filed separately.

[fol. 1273] Q. How long have you maintained that practice?

A. That has been in force ever since the first deposit was made to the Series B and the first deposit made to the Series D.

Q. On what date?

A. I don't recall the date.

Q. Well, is it within the last two or three years?

A. No, it goes back further than that, I am quite sure.

The Court:

Q. Are there any of these Series B in Wisconsin?

A. Yes, I believe there are.

Q. Then why were not deposits made separate there as well as in West Virginia?

A. Well, I can't answer that, because I don't have any correspondence or any knowledge what the negotiations were between my superiors and the State of Wisconsin.

Mr. Lauritzen:

Q. Who would be the person that would know all of the detail upon this particular subject that we are talking about now, beyond any question of doubt?

A. I believe Mr. Young would be the man, because he [fols.1274-1278] was responsible for making those arrangements, that is, when he took over that particular office.

. . . . . .

[fol. 1279] Q. And it was at your insistence that both Mr. Smith and Mr. Thomas were appointed West Virginia state court receivers?

A. I insisted on Mr. Smith's being put in. A representative of the company suggested that there be two.

Mr. T. C. Townsend: What was that last answer?

(The answer was read.)

The Witness: Calling my attention to the fact that Mr. Thomas had prepared the filing of papers with the Securities and Exchange Commission. Believing that the knowledge gained from the study of the company in making up those papers would be very valuable in analyzing this company and preparing any kind of reorganization plan, I [fol. 1280] agreed.

Cross-examination.

By Mr. Fleming:

Q. Mr. Sims, who prepared the petition that was filed in the local state court?

A. Who actually did the writing I do not know. Mr. Partlow, of the Attorney General's office, was in conference with us in regard to it.

Q. It has been suggested that Mr. Thomas prepared the petition.

A. I did not see him.

Q. Who did you consult with from the firm of Koontz and Koontz during that time?

A. I talked with Mr. Koontz before the suit was brought and told him what I was going to do.

Q. Well, he advised with you, did he not, in reference to it?

A. Well, in a general way, but I was advising him.

Q. I will ask you if it is not a fact that your petition was prepared in the law office of Koontz and Koontz?

A. You had better ask them.

[fol. 1281] Q. You don't know who prepared it?

The Court: State, if you know, Mr. Sims.

A. I do not know of my own knowledge.

The Court: All right.

Mr. Fleming:

Q. Who presented it to you for your verification?

A. Well, I can't say whether it was Mr. Partlow or a member of the Koontz firm or who.

Q. And who presented it to the Court at the time it was filed?

A. I do not know.

Q. You were not present at that time?

A. My assumption is Mr. Partlow, of the Attorney General's office.

Q. You were not present at the time?

A. No, sir.

Q. You did not go into court?

A. No, sir.

Q. You made no request of the Court as to who was to be appointed receiver?

A. Oh, you mean the court receiver down——

Q. The state court?

[fol. 1282] A. Oh, the state court.

Q. Yes.

A. Mr. Partlow was there, at my request.

Q. Who else was there—what other attorneys?

A. Mr. Koontz was there representing the——

Q. Company?

A. Company, I suppose.

Q. You don't know who prepared the petition?

A. Not of my own knowledge, but my assumption is that Mr. Partlow did.

Cross-examination.

By Mr. Huwe:

Q. Mr. Sims, are you prepared and able to tell us the exact date when those Marston and Paull securities were withdrawn by the company from Charleston?

A. No, sir.

Q. Who would be able to tell us the exact date when it was withdrawn and restored—partially restored?

A. Mr. Robert Brown.

Q. Is he in town again? He is still in town?

A. I don't know. I have not been to the office since away last week until this morning, and I left before he came in.

[fol. 1283] Q. Is it your knowledge that he has been on the job for the last few days?

A. I think he has, perhaps.

Mr. Huwe: All right; thank you.

The Court:

Q. Mr. Sims, there is something I want to ask you. You said awhile ago that a representative of the company suggested that there be two receivers. Who was that representative?

A. Mr. Koontz.

Q. What Mr. Koontz?

A. A. B.

Q. A member of the firm of Koontz and Koontz?

A. Yes, sir.

Q. And was he the one that suggested Mr. Thomas?

A. Yes, sir, and to clear my own reputation, if that be at stake, I call attention to the fact that Mr. Thomas was a member of their firm. I didn't know about the ethics of

that, but all things considered I would waive that because of Mr. Thomas' knowledge that I wanted to avail myself of in connection with the reorganization plans.

[fol. 1284] The Court: All right.

Cross-examination.

By Mr. Lauritzen:

Q. Mr. Sims, you became familiar and rather intimately acquainted with the Fidelity sales practices here in the State of West Virginia during your supervision, did you not?

A. Well, more or less, yes.

Q. Can you tell us what use the company made in its sales campaign here in West Virginia of the fact that they had a deposit with the State Treasurer of West Virginia under the laws of West Virginia?

A. I believe I saw a prospectus of the company containing much sales literature in which was shown the vault in the State of West Virginia in which their securities were kept.

* * * * * * *

[fol. 1285] Mr. Lauritzen:

Q. Mr. Sims, do you know whether it was a fact that here in West Virginia a large part of the sales campaign of Fidelity was based upon the fact that purchasers of contracts here in West Virginia would be protected by the state deposit?

A. There isn't any doubt about it.

Q. You know that of your own observations of this company?

A. Yes, many owners of contracts came to me and stated that they were informed that——

[fols. 1286-1292] Mr. Fleming: I think the debtor will object to any conversations between the Auditor and contract holders as purely hearsay and entirely beyond the realm of proper proof.

The Court: Well, I don't see any objection to that. I think the Court will take judicial notice of the fact that that played a large part in the sales of securities, the fact that we have such a statute as that. Still, if you want to go ahead, it is all right.

The Witness: Read the answer.

(The question and answer were read.)

A. That the State of West Virginia was behind the contracts. I had arguments with the holders of contracts.

. . . . . .

[fol. 1293] C. E. Smith, recalled, testified as follows:

Cross-examination.

By Mr. Lauritzen:

. . . . . .

[fol. 1294] Q. Are you familiar with the provisions of the contracts that Fidelity sold?

A. No, I am not. It has been so long since I was in that particular division of the company that I have forgotten most of the terms.

Q. We were talking about the fact that there were various series of contracts, A, B, C and so on, and you testified that securities were placed in those various funds and were earmarked, so to speak, on the books of the company with respect to those funds.

A. That is right.

Q. It is a fact, is it not, that with respect to the fifteen states which required deposits that those securities when they were sent out to those states did not bear any particular earmark?

[fol. 1295] A. I don't think that that would hold true in all cases. I believe——

Q. I would like to have you be very careful and particular about this and get the information for us, if you don't have it here, and tell us precisely what was the situation in that regard. If you remember now, I wish you would tell us.

A. Prior to the issuance of the Series B contracts I don't think that any earmarking was indicated.

Q. And when was the Series B first issued?

A. And when the Series B was first issued—I don't recall the date of the first issue——

Q. Was it around 1934?

A. I think that is about correct—a deposit going out to states, other than West Virginia, as I recall Mr. Young's

letters indicated those securities were for the Series B account.

Q. To West Virginia?

A. Other than West Virginia—that is states other than West Virginia.

Q. Would you say that held true for Wisconsin?

A. Yes, I think it did.

[fols. 1296-1305] Q. You looked at those letters that I showed you yesterday, and you didn't see——

A. There was nothing in there of that nature, but I am speaking of the earlier letters they had just when the first deposits were being made for the Series B fund. One thing I do recall, no Series B and Series D, and that is that the indentures required that the securities belonging to those funds be kept separate and apart from the securities belonging to other funds.

Q. What indenture do you speak of?

A. The terms of the contract.

Q. The terms of the contract in the Series B was the same as the terms of all the other contracts with respect to the maintenance of reserves, was it not?

A. I believe there is a reference in there to the assets of the Series B fund, in which it stated that those assets should be kept separate and apart from the assets of other reserve funds.

* * * * * * *

[fol. 1306] Mr. Lauritzen:

Q. Mr. Smith, after you have sold a large amount of one series of contracts in one particular state, and then you abandoned that series and that series began to mature and then you started selling another series, it wouldn't be very practical to ascertain from day to day what your growing liability on the new series was and to have at all times out in that state securities purchased with cash arising from those particular sales going on at that time, would it?

A. No, it would not have been practical. In fact, I doubt whether it would have been possible to do it that often, that is, on a day to day basis. As a matter of fact, just in recent years the taking of an inventory by states was quite a task.

[fol. 1307] Q. Isn't it a fact that if you wanted to unscramble all these securities now and yet comply with each

state law, from your knowledge of that securities port folio it would be impossible?

A. I don't think it would be impossible, generally speaking.

Q. Have you examined the securities to see whether you could unscramble them and yet have enough securities of the particular kind acceptable in each of the fifteen states where you had deposits?

A. I don't think you could find enough to—that is, I don't think you would get enough of the acceptable types to cover the requirements of all fifteen states, but you could certainly do considerable to cure the present deposit deficiencies.

Q. In what states?

A. Well, take Wisconsin, that requires securities, I believe, either government or Wisconsin municipals.

Q. And that is what you put out there, isn't it?

A. Yes, we have got those out there. There are, I believe, still some industrial and utility bonds out there which were deposited before—before the——

[fol. 1308] Q. Before the present law?

A. Before the present requirements were instituted.

Q. Before what I am speaking of, rather than that, Mr. Smith, is if you would make an attempt to place securities series by series and series for series in each state and still meet the state requirements, your knowledge of the securities port folio of this company would tell you that that couldn't be done, wouldn't it?

A. Well, I still would like to have a whirl at trying to do it.

Q. How long have you been trying to do it?

A. Well, as I say, there has been considerable effort made since 1939 to cure that. The whole thing—I shouldn't say the whole thing, but a good deal, revolves around the willingness of the officials of the various states to release bonds of one type against the deposit of bonds of another type. It is a matter of releasing them for a period long enough to get them into transit.

Q. But you were never successful in accomplishing that?

A. Not entirely.

Q. Did the states fail to cooperate with you that regard?

[fol. 1309] A. I don't think you could call it failure to cooperate. They simply wished to protect themselves, because it would mean the surrender temporarily, for perhaps

a day or two, of certain securities by one state in order to get that deposit in another state against a withdrawal in a second state which would go back to the first state.

Q. You never made any proposition to the various states that they should consult between themselves and make the changes, did you?

A. No, I didn't mean to indicate that such a proposition had been made.

Q. As a matter of fact, some of the states, after the SEC proceedings, definitely told you to put down securities fund by fund in their states, didn't they?

A. I can't answer that, because I don't know.

Q. Who would have information on that?

A. I believe that would go to Mr. Young. It should, because he was in charge of making the deposits.

Q. Let us suppose that in some manner you and Mr. Young had succeeded in unscrambing this whole thing, and [fol. 1310] going on the theory that you had to have securities fund by fund in each state and still meet the deposit requirements, now before many days or a month had gone by and you began to sell various series contracts in various states, you would be out of balance again, wouldn't you?

A. Yes, you would be, as a temporary thing. You would at least—you would at least be out of balance until an inventory of your liability was taken, and once that was determined it would be a matter of getting your deposits in agreement again.

Q. You never attempted to maintain any records in your company that would enable you to keep any such balance of deposited securities, did you?

A. Not in all states. There were a few states that requested monthly reports of liability in their respective states.

Q. And in their respective funds?

A. They did not, as I recall—at least, we didn't prepare our securities values by funds. We prepared them en toto.

Q. Yes.

[fol. 1311] A. And that was with the exception of Wisconsin, which—oh, I think back as far as 1939 or 40 asked us to submit reports of deposits and liability by funds.

Q. The other states didn't ask you to do that?

A. I couldn't answer that accurately, because, as I state, the request from the states would not come to me.

Q. Who was it, in your firm, that had charge of looking over the various state laws and then handling the mechanics of Fidelity's complying with those laws?

A. Well, that would come under Mr. McNulty's jurisdiction.

Q. Mr. McNulty's?

A. That is as far as maintaining contacts between the states and Fidelity is concerned. From there on it would mean other departments working in with him.

Q. And if the state officials in a particular state were satisfied with the deposit that you had made there and in accordance with Fidelity's reading of the state law in making that deposit you had complied with the state laws, wouldn't you consider that you had then done enough?

[fol. 1312] A. I would consider that we had done all that could be done, yes.

Q. And it wouldn't make any difference as to those deposits whether you had fund for fund in those states, if the state law didn't provide for it, would it?

Mr. Huwe: Your Honor, I object to that particular question for the reason that he is asking this witness his opinion about a legal question. In other words, the legal question is whether or not the debtor company was obligated by the state laws or by the West Virginia laws to maintain these liability deposits in the respective states in proportion to the cash surrender liability in those respective states. This witness is incompetent to give a legal conclusion on that question, and the question that Mr. Lauritzen has asked him requires such a conclusion. After all, even if the debtor, with intention or accidentally and innocently, violated its trust obligations by putting more, we will say, series B securities in one state than belonged in that state, that is a question that is a violation, perhaps, of the obligations, regardless of the intention of any of the company's officers or of any particular employee of the company, or [fol. 1313] regardless of that particular employee's particular opinion of what he should do or should not do, so I think that that question is objectionable for that reason, asking for that kind of conclusion.

The Court: I sustain the objection.

Mr. Lauritzen: I think I can explain my purpose to Mr. Huwe. Mr. Smith has answered that he felt that they should do certain things, and I asked him what led him to

that conclusion, and apparently it was based upon what his interpretation of the contracts would be, which I will grant you is perhaps a question of law, but I am trying to bring out here what the actual practice and operation of this firm was over the entire period of their business career with respect to living under the various state laws under which they operated, and I think that is highly pertinent——

The Court: You can do that, but the question you just asked is objectionable, in my opinion.

Mr. Lauritzen: Well, I will withdraw the question. Will you read the question?

(The question was read.)

Mr. Lauritzen: I will withdraw that.

[fols. 1314-1315] Q. Mr. Smith, it seems clear that you did not have fund for fund in the various states. I guess we all concede that, don't we?

A. That is correct.

Q. And yet for a long period of years you operated in those states and apparently the state authorities were satisfied with your deposits there and the fact that you had in other respects qualified under the state laws? Is that correct?

A. Apparently so, yes.

* * * * * * *

[fol. 1316] By Mr. Schurr:

Q. Mr. Smith, for our information, it was the policy of the company not to earmark funds prior to the issuance of B Series, or maybe at a later date, when the SEC brought the injunctive proceedings—is that correct, sir? What I mean, the states did not require the earmarking of securities?

A. You are speaking of deposits?

Q. Yes, there was no state law in West Virginia under which you operated requiring the earmarking of securities for a particular fund or series of contracts, was there?

A. Not that I know of, but actually the securities were earmarked on our records, that is, for a particular fund, irrespective of the place of deposit.

[fols. 1317-1320] Q. But I mean for some time the company operated prior to the proceedings instituted by the

SEC—it was their policy not to earmark any funds, was it not?

A. No, because the Series B issue had come out before the SEC proceedings, and the Series B securities were earmarked.

• • • • • • •

[fol. 1321] Q. You were familiar with the fact that a consent decree entered in that case in Detroit enjoined this company from failing to maintain in West Virginia and other states sufficient securities to meet the deposit requirements and at the same time from failing to segregate and maintain at all times sufficient statutory deposits against appropriate liabilities and from failing to create and maintain separate contract reserve funds, are you not?

A. Yes, I am familiar with that.

Q. After that decree were entered the company undertook to comply both with the injunction restraining it from *maintaining* the required deposits in the states and that phase of the injunction that prohibited it from *maintaining* sufficient reserve requirements on the different series of contracts.

[fols. 1322-1330] A. I think every effort was made, yes, to comply with the order.

Q. You couldn't do it because the company was insolvent and broke?

A. Well, that is very likely.

• • • • • • •

[fol. 1331] Mr. Fleming:

Q. I will ask you to explain why you say those items were worth par?

A. Well, take the home office mortgage. That is our home office building in Wheeling, built in 1937 and 1938.

Q. At what cost?

A. At a cost of approximately $450,000; and here is a mortgage, including the first and second, of $450,000. I [fol. 1332] think that—on that particular mortgage I think the value is behind it, surely.

Mr. Palmer: We object to the answer. The witness has not qualified himself.

Mr. Fleming: Let me find out what this other real estate mortgage is.

The Court: Well, let's see about that answer first. He gives you the cost in 1937, says it is mortgaged to the full amount of the cost, and then says he thinks that there is full value behind it. I think the answer itself shows that this witness is not acquainted with the fact that real estate always deteriorates somewhat after construction.

Mr. Fleming: I had the impression, Your Honor, that this other real estate item of $215,000 was mortgage on real estate other than the home office.

The Witness: Other than the home office.

The Court: I will strike out the answer if it is objected to.

Mr. Fleming:

Q. Then, Mr. Smith, as I understand, the home office mortgage in the sum of $296,790 was upon the home office [fol. 1333] building at Wheeling, which was constructed two or three years ago at a cost of $450,000.

A. That is right.

The Court: Four years ago, he says.

A. '37 and '38, the home office building, about three years ago.

Mr. Fleming:

Q. And the item "other real estate mortgages" in the amount of $215,000 consists of mortgages upon other real estate?

A. On other real estate, yes.

The Court: Let's see. I want to get this straight, because unless we do it won't do me any good. This witness said a minute ago that he had two mortgages there amounting to $450,000 on the home office building, in other words, the exact cost of it. Now you are restricting it to one mortgage of $296,000.

A. Your Honor, the first mortgage on the property, which is on deposit with the State of West Virginia is $296,790. Then there is a junior mortgage on the property of $153,210.

Q. Where is that one?

A. That is in the hands of the trustee.

Mr. Palmer: Speak up, Mr. Smith; we can't hear you. [fols. 1334-1337] The Witness: Oh, pardon me. I say that is in the hands of the trustee, I believe.

The Court: That would seem to be the one whose value might be questionable, then.

Mr. Fleming: Yes. I might be mistaken, but I had the idea that this "other real estate mortgages," $215,000, did not include that mortgage.

The Court: Let's see if it does.

Mr. Fleming:

Q. Does the item of "other real estate mortgages", included in the schedule marked debtor's exhibit 57 and bearing date December 31, 1940—include the second mortgage upon the home office building concerning which you have just testified?

A. No, the item marked "other real estate mortgages" of $215,000 does not include that second mortgage.

. . . . . .

[fol. 1338] Q. Well, take the schedule as of April 10th. That covers those same properties, doesn't it, and in the same amount?

A. This is the same amount.

Q. Yes. Isn't — a fact, Mr. Smith, that Fidelity at that time only had eight properties in all?

A. That is true.

Q. Well, if they only had eight properties and that was all the real estate it had in that schedule, would it be possible for you to reconcile that figure with the ownership of those properties?

A. Yes. Here is the point. In these assets the home office building is covered here under mortgages, since it [fols. 1339-1343] is under mortgage, and it is covered under that title, so that the $438,105.11 as of June 6th would be the other properties.

. . . . . .

[fol. 1344] The Court: Mr. Smith, I gather from all these [fol. 1345] answers of yours that with the exception of the home office building, which you think is worth about what it is carried on the books for, and the lots in Parkersburg, that with reference to the other real estate there is a difference of approximately twenty to twenty-five per cent in the actual value and the value at which it is carried on the books. Does that about get it?

A. I think that would be a fair valuation.

Mr. Fleming:

Q. As to the item of $153,000 which you have testified comprised a second mortgage upon the home office building, where is that item carried?

A. With reference to this schedule, you mean?

Q. Yes. It is carried in the securities, I assume?

A. Yes, it is carried in the securities.

Q. You may explain to the Court, if you will, how that particular item was valued by you in making up this schedule.

A. That was valued at book value, just as——

Q. It was valued at book value?

A. At book value, yes.

Q. What would be your opinion about that now? Would that be worth quite book value, do you think?

[fol. 1346] A. That is difficult to say. I think it would be, very close to it.

Q. You think it would be?

A. Yes.

The Court: Well now, how would that be possible, Mr. Smith, in view of the fact that you say the home office building is not worth more than $425,000 as a maximum? You gave a minimum, I think, of $375,000, and there is a prior mortgage against it of $296,000, and then you have this mortgage of $153,000, how could this mortgage possibly be worth its face value?

A. That doesn't seem—it doesn't seem possible.

The Court: No. It doesn't to me.

Mr. Fleming: I think probably this mortgage should be evaluated in the light of his previous testimony.

The Court: Yes, you may proceed. The Court will draw his own conclusions.

Mr. Fleming:

Q. You say you have been with Fidelity since 1917?

A. Yes, 1917.

Q. Have you been acquainted with the character of the business transacted by Fidelity and its activities during [fol. 1347] that entire period from 1917 up to the present time?

A. Yes, in a general way.

Q. I will ask you whether or not Fidelity ever engaged in any business, either in West Virginia or outside of the State of West Virginia, other than the sale of these contracts concerning which you have testified?

A. No, not that I know of.

Q. The special annuity and the special income and the A, B, C and D classes of annuity contracts?

A. No, I don't know of any business other than contracts.

Q. I will ask you whether or not during this entire period the books of the company were open to inspection to the officials of the various outside states in which Fidelity was selling these contracts?

A. Oh, yes, they were open at all times for inspection.

Q. And I will ask you if, from time to time, representatives of those various states came to Fidelity for the purpose of ascertaining the nature and character and amount of your assets and the manner in which your business was [fol. 1348] being handled and transacted?

A. Yes, there would be periodical examinations by representatives of the various states.

Q. And if at times representatives—that is, what might be termed convention representatives representing all of the states in which contracts were being sold—came to your home office for the purpose of ascertaining all facts relative to the operation of your business?

Mr. Palmer: If Your Honor please, I do not want to object to this, but it has been gone over even in greater detail than Mr. Fleming is going over it now earlier in the case.

Mr. Fleming: I am not wanting to go into details; I just want to cover it generally.

The Court: Go ahead. I think it has ben covered by another witness, but there was a little controversy about it as I recall——

Mr. Lauritzen: May it please the Court, we have another objection to the question, when he asks with reference to all states and the purpose of the men coming in there to examine for all purposes, I don't see how the witness can possibly give an answer as to all facts.

[fol. 1349] The Court: Read the question.

(The question was read.)

The Court: I overrule the objection.

A. The convention representatives were at the home offices in 1940 and at various times there were other representatives of other states that would come in and make their examination.

Q. You were explaining to the Court, Mr. Smith, that each fund, as representing the contracts sold in that fund—you have your records by means of which that fund is kept entirely separate and apart from each other fund. Is that right?

A. That is correct.

Q. And that all securities purchased through the use of monies obtained from the sale of contracts in that fund are earmarked and kept separate for the purpose of identification?

A. On our records, yes, sir.

Q. As to that particular fund?

A. That is right.

Q. You have a ledger showing each specific fund and the amount of money that has come into the company through [fol. 1350] that fund and the amount of securities and the character of securities purchased with those moneys?

A. Yes.

Q. As a matter of bookkeeping, just explain to the Court, if you will, how your bookkeeping transactions are handled, both as to the monies received through the sale of contracts in each specific fund and how the securities are handled, as a matter of bookkeeping, so they will be allocated and identified in relation to each specific fund.

A. I believe that the simplest answer to that would be that the collections from contracts are credited on it and the contract payments or money placed in the bank; and as your cash available accumulates the investment department would make recommendations to the investment committee for the purchase of securities, and when and if the securities were purchased, they would be allocated to whatever fund was in need of investments and that fund would pay for them.

Q. In other words, Mr. Smith, you could go to your own records, and if Fidelity had purchased a bond ten years ago from funds of Class A contract fund; you could find [fol. 1351] the number, the serial number of that bond and the amount of it?

A. Yes.

Mr. Farmer: If the Court please, I will take an objection to this question. It seems to me that is unnecessary repetition.

The Court: I overrule the objection, but I would like to ask this question.

Q. You say that the payments came in and they just went into a general fund?

A. No, no. They went into—they were credited to the contract fund and to the contract to which they belonged, the money going to the bank account—what I meant to say—what I should have said—was that as the payments from the contract holders were received they were credited to those contracts or to the contract to which they were meant to apply and were then deposited in the bank.

Q. Were they deposited in the bank just in a bank account of the Fidelity Investment Association or were they deposited there to some particular fund?

A. No, we have eleven bank accounts, one for each fund.

[fol. 1352] Mr. Palmer:

Q. That was as of what time? When did you start the eleven bank accounts? I think the Court would like to know that.

The Court: Yes.

A. I can't recall the exact date.

Mr. Palmer:

Q. That was after the SEC suit in Detroit? Up till then I think you told me yesterday you had one bank account, although you separated it on your own books?

A. I don't believe I gave that testimony.

The Court: What was the fact about that? When did those separate funds start, or did you maintain them from the beginning? I mean the separate bank accounts for the individual funds.

A. I can't very well answer that, because that question comes under the head of accounting, and I am not familiar with the accounting practices as affects accounting in general. Where it pertains to securities, the securities themselves I can answer——

Mr. Fleming: Mr. Schellhase is still here. Could he clarify that point?

A. I am quite sure he could.

[fol. 1353] Mr. Fleming: That is all, Mr. Smith, for the present.

Cross-examination.

By Mr. Palmer:

Q. You spoke of the Reymann property at Fifteenth and Eoff Streets as being worth twenty to twenty-five thousand dollars. Is that correct?

A. Yes.

Q. How long have you had that property?

A. That was acquired in the latter part of 1940 through foreclosure.

Q. How long have you had a mortgage on it?

A. That would go back, I believe, as far as ten years.

Q. And you have not had an offer to buy it in that time, have you?

A. Not that I recall.

Q. And it is situated catercornered from the county jail, isn't it?

A. That is right.

Q. And on the other corner is a mortuary?

A. Right.

[fol. 1354] Q. And on the other is the Elks Club parking lot?

A. That is correct. Wait a minute. Yes, that is correct.

Q. And it is a three story residential building of the old ornate type of fifty or sixty years ago—isn't that right?

A. That is right.

The Court: Are you considering the house as of some value, the building itself?

A. I stated that at prevailing prices it would be worth between twenty and twenty-five thousand——

Q. I mean, were you considering the building as a part of that value or were you just thinking of the land?

A. No, I was considering the building as included in that.

The Court: All right.

Mr. Palmer:

Q. Your tenants are the American Red Cross, the Boy Scouts and so forth, aren't they?

A. That is right.

Q. It is situated at least four to five blocks from the business section and the office section of the City of Wheeling? [fol. 1355] A. That is correct.

Q. Have the other valuations that you placed on real estate been on the same basis that you have valued this property on?

Mr. Fleming: I think we will object to this. This calls for a comparison, and——

The Court: Overruled.

The Witness: Your question again, please.

(The question was read.)

A. Yes.

Mr. Palmer:

Q. The Howard mansion that you are talking about was built about 1912, wasn't it?

A. That is correct.

Q. You have not had an offer to buy it since Fidelity has had it, have you?

A. Not that I recall, no.

Q. You cut it into apartments and the apartments are so big in size, that is, the rooms, that you have had great difficulty in even leasing it? Isn't that right?

A. That is correct.

Q. And in fact you have even had to pay the gas bills on some of the apartments because the gas bills are so [fol. 1356] enormous compared to the size of the apartments? Is that correct?

A. That is correct.

Mr. Palmer: In order to clear up one other thing—I have mentioned this to Mr. Fleming, and perhaps it will clear up something in the Court's mind—the statute of West Virginia requires a company such as Fidelity—first requires the Insurance Commissioner to require a deposit in the amount of $100,000, and after that the only duty is upon the company to keep the deposit up, and not upon the Insurance Commissioner or Auditor or Treasurer. In other

words, the Court was asking yesterday how funds could be taken out. There is no provision stopping the company from taking out any funds at all, or giving the Auditor any right to stop them, other than to put them into receivership proceedings. The single provision of the statute is that the company shall make this deposit and maintain it, and the Auditor wasn't given any power over that.

The Court: What does the statute say will happen if the company impairs its deposit?

Mr. Palmer: The Auditor can revoke their license.

[fol. 1357] The Court: Then that does give the Auditor practically the power to require it, doesn't it?

Mr. Palmer: Insofar as the funds or securities are impaired, but the duty of maintaining them is upon the company, and that is what I wanted to ask this witness about, with that in mind, Your Honor.

Q. Every time a person makes a payment on their contract, that meant that the company had a greater liability to that individual, isn't that true?

A. That is correct.

Q. And every day you had payments being made in hundreds of dollars upon contracts?

A. That is right.

Q. So that theoretically you would be required to immediately increase your deposit with the State of West Virginia or whichever state the money came from—isn't that right?

A. That is correct.

The Court: Wait a minute. You lose sight of the fact that contracts were maturing, don't you?

Mr. Palmer: I am going to come to that, Your Honor.

Q. It was impossible, as a practical matter, to make a [fol. 1358] deposit every day to meet the payments coming in? Isn't that true?

A. That is true.

Q. So that as a practical matter you did the best you could by making deposits in lump sums to cover payments which had been made individually over a period prior to the deposit?

A. That is right.

Q. And also isn't it true that the bond market fluctuated up and down?

A. Yes.

Q. The securities market?

A. That is right.

Q. So that from time to time you had with the same deposit a higher value and a lower value, depending upon the outside securities market?

A. Yes, that would contribute to a change in the deposit value.

Q. Now, is it also true that you had from time to time contracts maturing whereby you were paying off and thereby decreasing your liability? Isn't that true?

A. That is correct.

[fol. 1359] Q. Wasn't it impossible for you to make a differentiation between deposits made with the State in order to comply with the laws as to payments made and at the same time take deposits out where you were making payments back to maturing contract holders?

A. It would be quite difficult to do.

Q. In other words, I have this in mind. Your maturing contracts, were they older contracts? Is that true?

A. That is true.

Q. And the ones on which you were getting your liabilities increased by payments were the newer series of contracts? Is that correct?

A. That is correct.

Q. Now, using this only for an example, and not concretely in any manner, take the State of Wisconsin. If you had a sufficient deposit up there to meet all of your liabilities and the maturing contracts, say of the income series, were paying out at the rate of a hundred dollars a day, you were selling new Series B at the rate of a hundred dollars a day, so that your fund was always perfectly solvent according to their state laws—you didn't attempt [fols. 1360-1370] to take out a withdrawal periodically and put it back into that same fund, did you?

A. No, I don't think it was done on that basis.

Q. And as a practical matter it would have been impossible to make such withdrawals and redeposits from day to day, would it not?

A. That is correct; it would not be practical to do it.

Q. What you mean, from an economic standpoint, the expense of trying to keep books up to date and mailing your securities and receiving them would have required too large a force to do it as a practical matter?

A. That is right.

Q. So when you had a deposit that was sufficient to meet all liabilities, considering the balancing of outgo and intake of the company, you let that deposit sit there?

A. That was what was done, yes.

* * * * * * *

[fol. 1371] Mr. Huwe: Your Honor, I would like to present my amended answer for filing. I think all counsel have had an opportunity to examine it. I don't believe they have the right—they have the power but not the right, as I see it, to oppose it, for the reason that there is nothing that prohibits the creditor from amending his answer under the provisions of Chapter 10.

The Court: Not so long as it remains an answer controverting the allegations of the petition. That was the question I asked. Is it still in that category, or is it different from that?

Mr. Huwe: It raises no new issues. However, it does join in the prayer of the debtor, or rather, joins in the desire of the debtor in one of the sections where the debtor alleges its desire to be reorganized.

[fol. 1372] Mr. Palmer: If Your Honor please, the assistant Attorney General of the State of Ohio showed me a letter signed John J. Rivers just before lunch in which he asked that this company be not reorganized but be liquidated and give him his money. Now, here is Mr. Huwe's inconsistent position. That letter was written to the Attorney General of the State of Ohio and the Insurance Commissioner asking for relief.

Mr. Huwe: If you will examine that letter—I saw that letter, and it stated, back in May before the federal suit was brought, as far as I can recall, and even as late as August 4th, the initial days of this proceeding, Mr. Rivers and others were of the opinion that every one of the respective funds of the debtor belonging to contract holders were insolvent. The first two days' proceedings developed sufficient testimony to show that perhaps a majority of those funds were solvent. Then further testimony by Mr. Smith, by Mr. Schellhase and by others revealed that the majority of those funds are solvent.

Back on August 6th Mr. Rivers and myself filed a memorandum with the Court with respect to jurisdiction. At that

[fol. 1373] time, unaware of any activity of the trustee suggesting that the company be reorganized and even suggesting certain preliminary plans with reference to the deposit—at that early date we were convinced from the testimony and reports that had been submitted by the trustee, exhibits A and M, as well as by the testimony, of Mr. Smith, the ex-receiver, that a majority of the funds were solvent; and consequently, under those circumstances, we had to change our minds about the feasibility of reorganization; and that explains the difference. It is a difference of somebody who has been enlightened by the testimony and reports.

Mr. Palmer: The letter says "I want no part of any rehabilitation of this company. I want my money back." That doesn't indicate anything but one desire.

Mr. Fleming: If the Court please, I might briefly say this, that I don't think Mr. Palmer is in position to urge that question before this Court, because all of his clients that have appeared in this Court on the witness stand have testified that they were for reorganization, and now he is apparently representing them and fighting the problem of reorganization.

[fol. 1374] Mr. Palmer: I will ask that the remarks of counsel be stricken from the record as improper and incorrect. My clients have indicated throughout that they believe that this company could be reorganized in the state court and could not be reorganized in federal court, and our position in that has been consistent throughout. I believe the Court inquired of me personally on that and I explained it and the Court said he was satisfied with the explanation.

Mr. Fleming: I would like to refer to the record of Mr. Sims' testimony and Mr. Smith's testimony. Mr. Ross Thomas has not testified yet and I don't know what his attitude would be, but those are three clients you have, Mr. Palmer.

Mr. Palmer: That is correct. I think Mr. Sims and Mr. Smith both testified that it could not be rehabilitated as a face amount security company, and they indicated that it could be rehabilitated in the state court as an insurance company.

I would like to read this letter to the Court from John J. Rivers, Attorney at Law, May 14th, 1941, marked on it received May 15, 1941.

"Mr. Thomas J. Herbert, Attorney General and Mr. John [fol. 1375] Lilly, Superintendent of Insurance, Columbus, Ohio.

GENTLEMEN:

"This is a legal application to you as Ohio Attorney General, as Ohio Superintendent of Insurance, and as Ohio Supervisor of Bond Investment Companies by Daniel C. Rivers, a resident of Ohio, with an interest in the Ohio deposit of the Fidelity Assurance Association (Fidelity Investment Association) with a right to participate in such deposit, to file a cross petition or proper pleading in the current receivership case in the Franklin County, Ohio, Common Pleas Court, involving the insolvent Fidelity Assurance Association, or to commence a separate civil action in some court making the Fidelity Assurance Association a party to determine the right of Daniel C. Rivers and all other parties claiming an interest in said deposit to subject the deposit to the payment or satisfaction of all liabilities and to distribute such fund among the persons entitled thereto in conformance with the provisions of Ohio General Code Section 698, 699 and 641.

"Dr. Rivers' contract, 355B-175, provides for monthly [fols. 1376-1385] payments of $37.50, under which he has paid to $1875. The cash surrender value is $1450.50, and the value according to reserve on earnings indicated in the company's correspondence is $1439.40. I think that Dr. Rivers is entitled to this action on your part irrespective of the solvency or insolvency of the company, in view of the sections referred to. Here is a claim at the stipulated cash value amount which the company, by reason of insolvency, is unable to pay. He is not interested in the rehabilitation of the company, and since December 30th, 1940 has been attempting to obtain the return of his payments as indicated in his correspondence with the company.

Very truly yours, John J. Rivers."

Mr. Fleming: The debtor would like to move that this be stricken from the record. The reporter has been taking it. I don't think it is properly a part of the record.

. . . . . .

[fol. 1386] Q. Mr. Smith, in your testimony this morning some question was asked you whether daily calculations were made of the deposit requirements in the various states. I believe your testimony was that these were not made daily. Is that right?

A. That is correct.

Q. How often are they made?

A. A full inventory is made twice a year, as I recall, and in the case of several states requesting monthly reports their particular liability is calculated monthly.

Q. Did it prove to be a difficult or impossible task to supply this information monthly?

A. That is on the entire——?

Q. On the states that require a deposit?

A. No, because that involved comparatively—a comparatively small part of the records. I mean, the taking of that inventory from the records was only a small part of the total record. You see, taking an inventory is pretty much of a task. It means sorting down your individual cards into classes and different groups before you can even at-[fol. 1387] tempt to make a calculation; and where you are furnishing a liability report to states like—well, Illinois, Wisconsin and Missouri and I believe Iowa—I think one or two more; I don't recall them now——

Mr. Palmer: Will you speak up, Mr. Smith. It is impossible to hear back here.

The Witness: All right. It means you don't have to handle your whole record; just take out those particular items involved.

Mr. Jaegerman:

Q. You have no difficulty, then, in preparing the appropriate monthly reports for these states?

A. No, it is routine.

Q. And furthermore, you are able to break down those reports by series and by funds within the series?

A. Yes, we are able to do that.

Q. And didn't you do that in your basic calculations?

A. That I can't answer, because the calculation of the reserve requirements is——

Q. How about the actual deposit requirements—what you did?

A. Oh, yes, those we valued——

[fol. 1388] Q. By funds—by series, rather, and their funds within the series, and your records are so prepared——

A. Yes, information was so compiled, although, in pulling the information together in some states, we handled it not by funds but as a whole; but had it been requested by funds it would have been just as easy to do. There was, as I said this morning, I believe, one or two, perhaps three states—I know Wisconsin requested it—where we did break the deposit figures into fund groups.

Mr. Lauritzen: I would like to have you clear this up, Mr. Jaegerman. I understand he is testifying now as to a report of liabilities by funds, because he clearly testified before that the letters I showed him were typical of the letters that he sent to Wisconsin and other states which made no breakdown on deposits or securities. Do you have something contrary to that in mind?

The Court: Are you asking about liabilities?

Mr. Jaegerman: No, I am not talking about liabilities; I am talking about deposit of securities, and I thought that [fol. 1389] was the answer of the witness. Is that right, Mr. Smith?

The Witness: I was speaking of securities.

Mr. Lauritzen: If the Court please, Mr. Jaegerman's statement of what the previous answer was is not correct, because he distinctly told me they did not break them down into funds and he told me the letters I showed him were typical of letters forwarded to Wisconsin and other states.

The Court: I didn't hear Mr. Jaegerman make a statement as to what the witness said. I think maybe the witness has been a little contradictory, and you can get that on cross-examination.

The Witness: Did I answer that question?

Mr. Jaegerman: Yes, you answered my question. If Mr. Lauritzen wants to ask any questions he will do so on on cross-examination.

Mr. Lauritzen: May I have the question and answer, please?

(The question and answer were read.)

The Witness: May I qualify that?

The Court: Go ahead.

The Witness: What I was referring to was the monthly [fol. 1390] reports which were sent to these states. In other

words, a report of the liability as compared to the security deposits.

Mr. Lauritzen: May I ask a question? Mr. Smith, it is true that in Wisconsin, at least in recent months or years, you made a report each month showing the total liability in Wisconsin by funds? That is what you have just stated, isn't it?

A. Yes, sir.

Q. Do you mean to tell us that in those monthly reports you also showed in respect to the deposit of securities in Wisconsin out of the funds of which of the contract series the particular securities on deposit there had been purchased?

A. I am quite sure we prepared the information in that way.

Q. Did you send it to Wisconsin?

A. No, I don't say that I sent it. I say that I believe, and I am quite sure, that I prepared it in that way and forwarded it to the department which would make the final report. Now, whether the final report went in broken [fols. 1391-1394] down by funds, I can't answer at this moment.

. . . . . .

[fol. 1395] Mr. Jaegerman:

Q. Mr. Smith, is it not true that regardless of the increase [fol. 1396] or decrease in liability in a particular state due to cash surrenders or maturities, there were many other factors which affected the deposits and the deposit requirements of that state?

A. Yes, I think you are right.

Q. What are some of those?

A. Well, as I stated this morning, your deposit requirements in the various states differ. Some are purely statutory requirements and others are based on the market value of your deposit at a given date. Others were accepted at par.

Q. How about maturities and calls?

A. You can build up your deposit in a given reserve and you will eventually encounter settlements in the way of maturities and cash surrenders and similar settlements, which would reduce your liability within that fund; and in making those settlements you might make them out of your

current cash without disturbing your deposit in a given state. The result would be that your deposit of securities would be in excess of your requirements for that particular fund.

Q. But regardless of your cash liabilities, does a deposit remain static?

[fol. 1397] A. Well, ordinarily it should remain static, for as your liability decreased you would certainly be entitled to withdraw your excess securities.

Q. But aren't a substantial number of securities continually being called?

A. Yes, that is true.

Q. And aren't substantial numbers of securities being sold?

A. That is also true.

Q. And aren't the amounts involved in calls and sales much greater than the amounts involved in surrenders or maturities?

A. Well, I don't know whether that would hold true over a long period or not. Under normal operation, as I told you, your called bonds would closely approach your normal settlements, that is, your called bonds and maturities and—we will let it go there—your called bonds and maturities would be your most frequent means of liquidating your securities.

Q. And considering cash surrenders and maturities, is it not a fact that the cash surrenders in dollar value greatly exceed the maturities in dollar value?

[fols. 1398-1405] A. I can't answer that accurately, because I don't know. I don't have reason to go into those records.

Q. Isn't it true that certain contracts in a particular series may be cash surrendered or mature while other contracts in that same series are continuing to increase in value?

A. That is right.

Q. Any deposit released for a particular series because of a cash surrender or maturity would then be available as against contract liabilities increasing on other certificates of the same series?

A. That is correct.

Q. And wouldn't that account for a large portion of any released securities due to cash surrenders or maturities?

A. I think it would.

Q. The business that Fidelity sold was a long term business, wasn't it?

A. It was.

Q. What was the shortest maturity in any of these contracts?

A. The shortest maturity would be ten years.

* * * * * * *

[fol. 1406] HUBERT F. YOUNG called as a witness by the debtor, having been duly sworn, testified as follows:

Direct examination.

By Mr. Fleming:

Q. State your name to the Court, please.

A. Hubert F. Young.

Q. Where do you live?

A. Scarsdale, New York.

Q. How long have you lived there?

A. Since June, 1932.

Q. Did you ever live in Wheeling, West Virginia?

A. No.

Q. Have you — employed by Fidelity for some time?

A. Since June, 1932.

Q. What was the character of your employment?

A. General supervision of investments of funds.

[fols. 1407-1422] Q. What business were you engaged in in 1932 before you went with Fidelity?

A. I was selling securities.

Q. Where?

A. In Washington, D. C.

Q. And since being in Fidelity's employ where have you been, that is, where have you lived or had your office——

A. Same place, New York.

Q. Then your work was handled in New York.

A. Correct.

* * * * * * *

[fol. 1423] Q. It finally compelled you to cease active business operations entirely, didn't it, in 1940?

A. I wouldn't say that did, but we could not qualify under the Investment Trust Act that was passed in 1940.

Q. By reason of that you had to cease operations late in 1940?

A. Yes, because we couldn't qualify.

Q. In your opinion, from your knowledge and experience with the operations of Fidelity and your general business experience, what is your judgment in reference to the feasibility of rehabilitating Fidelity through a proper plan of reorganization?

A. I think it could be done and should be done.

[fol. 1424] Q. Will you explain that to the Court, please.

A. Well, in my opinion there are two ways it can be done. One is by making an insurance company, mutualized; the contract holders would own the company. One other way, the only other way I know to have a face contract company, have a new company with new capital absorb the various contracts, with liabilitity on a fair bas's, to be arrived at by market value and liquidating value of the various funds; and one reason I think it should be done I think 1938 was the largest sales of any year we ever had. As I recall it, we went at the rate of fifty to sixty million dollars face value. Those people who bought then have not had an opportunity of paying long enough to get a reasonable amount of money back on their investment. I think they should be allowed to continue to pay in, on a proper basis of course.

Q. What would you think about a third possibility of merging, say with an insurance company, and continuing to write annuity contracts but also engage in business in the general insurance field?

A. Well, that would be my idea, if we had a mutual [fol. 1425] insurance company, except not to merge. I don't know what advantage we could show to some other company, just offhand, probably could—why they should merge with us.

Q. Could that be done either with a stock company or mutual company?

A. I think that could be done with either, except in a mutual company you are giving your contract holders something for giving up something. I think we all know they will have to give up something, and they should be given some kind of compensation.

Q. In other words, you feel that in working out a mutual plan that a more generous arrangement could be worked out in behalf of the contract holders than with a stock company?

A. Yes, I think the association still has a tremendous lot of good will that is available, and if it was a mutual insurance company we would have many contract holders, and if they were participating in the profits it would throw a lot of business to it.

Q. Mr. Sims testified that during the time you were with the company the assets of the company increased [fol. 1426] approximately four million dollars—more than four million dollars—that prior to that time they were apparently considerably insolvent, that is, he thought they were, and since you had been with the company the assets of the company made that much gain.

A. You mean depreciation?

Q. Appreciation.

A. Yes, sir. I think that figure is about right, but I will say this, that I came there at a time when their port folio was depreciated about forty per cent.

Q. You came in 1932, right at the bottom of the depression.

A. Right at the bottom.

Q. When securities had less value than they probably ever had at any time during the history of our country.

A. That is correct.

Q. In 1937 Mr. Sims testified that the company, by reason of appreciation in the value of the port folio, became solvent.

A. It was solvent if you threw all accounts into one hopper. I think in 1937 the income account was insolvent; the B account was, of course, solvent; but throwing them [fol. 1427] altogether there was a surplus on market values. That lasted until that drastic break in the market in June, I guess it was, of '37. In the spring of 1937 it was entirely solvent, I thought, based on market values.

Q. But notwithstanding the break in the market in 1938, Fidelity probably did the largest amount of business it had ever done.

A. Yes, I think it did the largest business it had ever done.

Q. In other words, is it during periods of depression when people are attracted to contracts of the character sold by Fidelity?

A. Yes, I think a great many people were sure in their judgment and were convinced it was a good vehicle, because

it was diversification, and when they bought one of these contracts, they had part ownership in the whole port folio in that series.

Q. Are you familiar with the fact that in 1939 Judge Baker, in the Northern District, found that Fidelity was solvent at that time?

A. Yes, sir.

[fols. 1428-1429] Q. And has there been any appreciable change in the assets of Fidelity from 1939 to the present time?

A. I would say not an appreciable gain on a percentage basis, no.

Q. As a matter of fact, there has been considerable appreciation in the past two months, hasn't there, in the value of the securities in the port folio?

A. Yes, in certain categories, for instance, railroad bonds.

Q. What do you think about the possibility or probability of appreciation in the value of securities during the next two or three years ahead of us?

A. I think we have an excellent change of appreciation on the type of port folio we have, which consists largely of, you might say semi-speculative bonds and not a great many of the higher grade bonds, which can, I think, go down quite a bit.

[fol. 1430] Mr. Fleming:

Q. I will ask you particularly whether any of those letters were in reference to the segregation of securities deposited with the various states into the proper funds as contracted by Fidelity under their contracts which were being sold in those states or had been sold in those states?

[fol. 1431] A. Well, I have a definite recollection on one particular case.

Q. What case is that?

A. That was in Illinois.

Q. I think that letter is already in the record. Just what happened in reference to that, do you remember?

A. Why, yes. When we set up the Series B, the securities were supposed to have been kept separate physically, which I endeavored to do in Illinois by writing and asking them to do it. I received a letter back which said that Secretary of State Hughes refused to separate the securities held on the various series of contracts.

Q. Did you have some experience with Wisconsin?

Mr. Gray: Is that letter available?

Mr. Fleming: Yes, it is in evidence.

Read the question, please.

(The question was read.)

Q. (Continuing:) In this same field?

A. Yes. I don't recall whether we had much correspondence or not, but I had a meeting with them at one time in Wheeling.

[fol. 1432] Q. When was that?

A. That was in the spring of '39, at the same time——

Q. Was that subject discussed in that meeting?

A. It was discussed.

Q. Do you remember what was said about that, in substance?

A. Well, the figures were produced, as I recall it, showing our liabilities in various accounts and our deposits in various accounts, and I was requested as expediently as possible to try to balance the deposits with the liabilities.

Q. In other words, I understand Wisconsin made a very good effort to comply with the contractual obligations which Fidelity had in contracts with the contract holders?

A. Yes, sir.

Q. Did you have any experience with Tennessee?

A. (Referring to papers.) With Tennessee I don't recall any specific instances with reference to accounts.

Q. Do you remember any other states outside of Wiscon-

[fol. 1433] sin and Illinois?

A. No, I don't recall any.

Q. What about Missouri?

A. Well, Missouri has always been practically balanced. I don't think we ever had a discussion on it.

Q. Generally how did you distribute these securities which were transmitted by you for deposit to the various states under their respective state laws?

A. We always asked the states to approve the deposit before making the shipment.

Q. Was there any reference to the allocation of these deposits to any specific contract fund?

A. No, not until recent dates.

Q. All right. And now, from 1932 up until say—when? 1939?

A. '38 or '39.

Q. '38 or '39. You transmitted the securities for deposit in the various states, as required by them under their state statutes, without reference to segregation?

A. That is correct.

Q. (Continuing:) Of these securities to specific contract [fols. 1434-1439] funds. Is that right?

A. That is correct.

Q. But since 1938 you have made an effort to accomplish that, have you?

A. Yes, we have.

. . . . . .

[fol. 1440] Mr. Reinhardt:

Q. Well, will you describe your understanding of the fund theory and then explain the dealings the company had with the states with respect to that.

A. I think I know what you refer to as the fund theory. That is each separate series in a separate fund on our books, and it is kept that way, of course, except with the states, say West Virginia, for instance, which has a central depository, we always advised, and I think ever since we have been here, what accounts they are coming out of, because they covered the whole country. In Illinois we attempted to segregate the securities and the state advised that they would not do that, and so they were deposited for several years there just as one general fund rather than by each individual fund.

Q. In your discussion will you please try to indicate [fol. 1441] dates, as nearly as you can fix them?

A. Well, in Illinois I wrote the Treasurer in 1935 and requested segregation, and I was advised that the Secretary of State——

Mr. Gray: If those letters are available I would prefer that they would be admitted instead of the gentleman's conclusions about them.

Mr. Reinhardt: Have you a copy of the letter that you just referred to?

A. That I wrote, yes.

Q. Is this a copy of that letter?

A. That is a copy of that letter.

Mr. Reinhardt: I ask that that be marked as an exhibit.

Exhibit 60

The paper referred to was marked as above indicated.

Mr. Reinhardt: I offer this letter in evidence as Exhibit 60.

Mr. Gray: No objection.

Exhibit 60

The paper referred to, having been previously marked as above indicated, was admitted in evidence. The same [fol. 1442] is attached hereto as a part hereof.

Mr. Reinhardt:

Q. Will you tell the Court what the reply was that you received to that letter, or do you have the reply?

A. I do not seem to have it in my files, but the reply was that they were instructed not to segregate by the Secretary of State.

Mr. Gray: Unless the letter is properly accounted for, I don't believe the conclusion of this witness would be proper.

The Witness: I did have it.

Mr. Reinhardt:

Q. Mr. Young, I show you debtor's Exhibit 59 and ask you whether that is the letter that was received in reply to Exhibit 60?

A. That is.

Q. Would you be good enough to read the relevant portions of Exhibit 60 and Exhibit 59?

A. Exhibit 60—this is a letter written by myself to the Treasurer of the State of Illinois in which I listed a shipment being made of $50,000 and detailed the bonds. Under our regular account, two thousand Pure Oil Company fifteen year Sinking Fund Notes 4½, 1950. Then I listed under [fol. 1443] special Series B account $33,000 Pure Oil Company fifteen year Sinking Fund Notes 4½, 1950, and same description, $15,000 Edison Electric Illuminating Company of Boston, First A 3½, 1965. Listing them I wrote:

"You will please note that $48,000 of these bonds are in our Special Series "B" Account which is the contract we are at the present time selling in Illinois. It is necessary

that these bonds be kept physically separate from other bonds now on deposit with you. and we will appreciate your advising us that this has been done.

"Upon receipt of the above bonds, will you please ship to Central Hanover Bank & Trust Company, Madison Avenue & 42nd Street, New York, N. Y., for our account, against receipt, the $50,000 San Joaquin Light & Power Co. Unifying & Refunding 5s, 1957."

I received reply under date of August 5th, 1935, from the Treasurer. The important part is, he acknowledges receipt of these securities I listed. Then he has this paragraph.

"We have been instructed by Honorable Edward J. [fols. 1444-1445] Hughes, Secretary of State, to issue one receipt for the $35,000 Pure Oil Company Bonds, as they intend to have only one account.

"In compliance with your request" we are shipping the others back.

. . . . . .

[fol. 1446] Mr. Reinhardt: Mr. Young, I show you a copy of a letter dated June 13th, 1939, and ask you whether that [fol. 1447] is a copy of a letter sent by you to Mr. John L. Lloyd, Commissioner of Insurance for the State of Ohio?

A. It is.

Mr. Reinhardt: I ask that that be marked, Your Honor.

Exhibit 61

The paper referred to was marked as above indicated.

Mr. Reinhardt: I offer that in evidence as Exhibit 61.

Exhibit 61

The paper referred to, having been previously marked as above indicated, was admitted in evidence. The same is attached hereto as a part hereof.

Mr. Reinhardt:

Q. Do you have the reply that you received to this letter, if you received a reply?

A. I don't recall having received a reply.

Q. Now, Mr. Young, will you continue with your general statement on this subject?

A. Well, I was on the deposit in the State of Illinois. Up till the fall of '38 we were required to keep on deposit

with them securities with a value equal to our liability since [fol. 1448] July 7th, 1931. In the year '38 other legislation was passed making it retroactive, where we were required to bring our deposit up to the full extent of our liability, which was practically impossible for us to do, for the securities sold before that date in the State of Illinois were largely annuity contract bonds. We were trying to raise new capital at that time and we wanted to keep the state open for business, and the officials were cooperative—they said, "Well, if you will deposit another $50,000 on your prior to July 7th, 1931, you can continue to sell for thirty days more or sixty and see if you can pull your losses up." After that was done, naturally those securities had to be the ones we had earmarked for the annuity account, and they requested then that we did segregate, and when I wanted to make withdrawals or substitutions I was told then they wanted to segregate their accounts, while under the previous instructions they positively would not segregate them.

The Court: Mr. Young, explain why it was that you found it impossible to make the deposits to cover the annuity contracts.

A. Because we had them in other states who would [fol. 1449] not let us withdraw them, for instance, in West Virginia. We had to keep certain securities down here, and the Auditor of West Virginia, or the particular officer in any state, would hardly let you withdraw from that state to put them in another state, and we were short that much. The annuity account, of course, is one of the insolvent accounts, and there was simply not enough securities to go around.

Mr. Jaegerman: Would the decline in the market value of securities in your income and annuity account have something to do with your lack of sufficient deposit?

A. Oh, sure; if we could have done it on book value instead of market value it would have been all right.

Q. So it was the requirement of market value by the states, plus your shrinkage that made it impossible to cover the deposit?

A. That is correct.

Mr. Reinhardt:

Q. When was it that Illinois indicated to you this reversal in feeling?

A. The first time I recalled—this spring—recall having [fol. 1450] anything before this letter, March 14th, 1941—I don't think there was anything before that.

Mr. Reinhardt: I ask to have this letter marked as an exhibit.

Exhibit 62

The paper referred to was marked as above indicated.

Mr. Reinhardt: I offer it in evidence as Exhibit 62.

Exhibit 62

The paper referred to, having been heretofore marked as above indicated, was admitted in evidence. The same is attached hereto as a part hereof.

Q. Will you read the relevant portions of that letter?

A. "I note your request for the transfer of certain securities from those now securing the liability on contracts sold since July 7, 1931, to the former account. The Department would prefer not to make any change in the deposits as they now stand other than your regular withdrawals and substitutions.

"At the time the original deposits of securities were made to secure the liability on contracts sold before July 7, 1931, [fol. 1451] a separate record of such deposits was made and the list given in my letter of March 1, 1941."

That is the pertinent part—which he segregated into that account.

Q. Now will you continue your statement?

A. Well, that covers the State of Illinois from my standpoint, as far as the substitutions, and in Wisconsin I made one statement—I had a conference with one or two of their officials in Wheeling in the spring of approximately '39 in which they asked that we bring the accounts into balance, which we have attempted to do.

Q. When you say "bring the accounts into balance" what do you mean?

A. By funds, having the securities in one fund in one state equal to the liabilities of the same fund in the same state.

Q. Is there any other correspondence that you had with Wisconsin which you regard as relevant to this controversy?

A. Only to the fact that they knew that we did have the various accounts, and they did know that they were not entirely balanced. I have a statement here of January 31, [fol. 1452] 1941, showing the liabilities of each account. We have a letter of February 21st pertaining to it.

Q. I show you a telegram dated February 20th, 1941 addressed to you by Frank H. Bixby, Commissioner, sent from Madison, Wisconsin, and ask you whether that is a telegram that you received from the officials in the State of Wisconsin charged with the administration of the Wisconsin deposit?

A. It is.

Mr. Reinhardt: I ask that that be marked.

Exhibit 63

The paper referred to was marked as above indicated.

Mr. Reinhardt: I offer that in evidence as Exhibit 63.

Exhibit 63

The paper referred to, having heretofore been marked as above indicated, was admitted in evidence. The same is attached hereto as a part hereof.

Mr. Reinhardt: Your Honor, I think it would be simpler if we introduced this whole batch of letters from Wisconsin as one exhibit.

The Court: I see no objection to that.

[fol. 1453] Mr. Reinhardt: They all speak for themselves and require no particular discussion.

Mr. Gray: May I interrogate this witness while they are examining those papers?

The Court: Yes.

Mr. Gray: Did you reply to Secretary Hughes' letter that you have marked here number fifty-nine?

A. I don't remember just which number fifty-nine is.

Q. That is the one that you say that he didn't reply to your request for segregation?

A. No, I don't recall a reply to that letter.

Q. Did you make a reply to that one in 1941 in March?

A. I am not sure. (Witness refers to paper.) I don't recall it and I don't seem to have a copy.

Q. That ends the correspondence so far as you know, about it?

A. From my memory, yes.

Q. Do you have charge of procuring authority to transact business in the several states, or some of them?

A. No.

[fol. 1454] Q. Just what were your duties with reference to contacts with sister states?

A. My only duties at all was handling the securities.

Q. What?

A. Only handling and depositing and withdrawing of securities.

* * * * * * *

[fol. 1455] Mr. Reinhardt: I am offering in evidence a series of letters that passed between Mr. Young and officials of the State of Wisconsin, and ask that those be marked as one exhibit.

Exhibit 64

The papers referred to were admitted in evidence, marked Exhibit 64a, Exhibit 64b, Exhibit 64c and Exhibit 64d. The same are attached hereto as a part hereof.

Mr. Reinhardt: This exhibit consists of four letters, marked respectively a, b, c, and d, a being one page, dated February 13, 1941, b being two pages dated February 21, [fol. 1456] 1941, c being two pages dated February 28, 1941 and d being one page dated March 3, 1941.

Q. Mr. Young, do you have any reports furnished to you by officials of the State of Wisconsin or furnished by you to officials of the State of Wisconsin——

A. Yes, sir, I have both.

Q. (continuing): In which the securities deposited with the State of Wisconsin are segregated according to funds?

A. Yes, sir. This was furnished me by the Examiner for the State Banking Department of Wisconsin.

Q. On what date?

A. Market values as of January 27, 1940.

Q. Do you recall when that was furnished to you?

A. No, I don't remember the date on that, but I presume shortly after the computations were made on market values.

Q. In other words, you received that around January 27, 1940?

A. Yes.

Q. Or shortly thereafter?

A. I would say shortly thereafter.

Mr. Reinhardt: I ask that that be marked, Your [fol. 1457] Honor.

Exhibit 65

The paper referred to was marked as above indicated.

Mr. Reinhardt: I offer that in evidence as Exhibit 65.

Exhibit 65

The paper referred to was admitted in evidence, having been previously marked as above indicated. The same is attached hereto as a part hereof.

Q. Have you a statement that was furnished by you to an official of the State of Wisconsin indicating a segregation of securities by firms?

A. Yes, that was furnished them monthly. I happen to have one copy with me, but every month that was worked up at Wheeling, and copies sent to the proper officials and then it would come to my office.

Q. How long did that practice continue?

A. We always kept them advised. Whether we did it monthly up till about three years ago I am not sure.

Q. Your recollection is that it goes back at least three years?

A. Yes, I am positive of that.

[fol. 1458] Q. And it may have gone back beyond that?

A. It may have gone back beyond that.

Q. This particular one is dated February 28, 1941?

A. That is correct.

Mr. Reinhardt: I ask that that be marked.

Exhibit 66

The paper referred to was marked as above indicated.

Mr. Reinhardt: I offer that in evidence as Exhibit 66.

Exhibit 66

The paper referred to, having been heretofore marked as above indicated, was admitted in evidence. The same is attached hereto as a part hereof.

Mr. Reinhardt:

Q. Is this Exhibit 66 typical of the reports that were furnished monthly to the State of Wisconsin during the last three years and perhaps even earlier than that?

A. Yes, it is a typical statement.

Q. Were similar reports furnished to other states in which deposits were maintained by Fidelity?

A. Yes.

Q. Can you tell us to what other states reports of this [fol. 1459] kind were furnished?

A. To Missouri, Illinois, Alabama and I think Tennessee.

Q. Were there any other states to which such reports were furnished either periodically or at any particular time?

A. Yes, they were furnished after the annual audit each year.

Q. To which state were they furnished yearly?

A. I would presume all of them. That was not under my supervision, but I would presume that it was furnished to all states.

Mr. Reinhardt: I think that concludes my examination on that, Your Honor. It might be that the states would want to cross examine on that particular point immediately, before Mr. Jaegerman goes into the matters mentioned by Your Honor.

The Court: All right, if you care to do that, gentlemen.

Mr. Lauritzen: Do you mean on the letters and reports? Yes, if the Court would permit.

[fol. 1460] Cross-examination.

By Mr. Lauritzen:

Q. Mr. Young, calling your attention to Exhibit 61, a copy of a letter written by you to John Lloyd, Commissioner of Insurance of Ohio, in which you inform him that you have recently purchased for your Series D account approximately a hundred thousand FHA mortgages with a view of depositing them with Ohio, can you tell us whether or not those mortgages were deposited with Ohio?

A. No, I couldn't. It has been quite a while and I don't remember whether they were or not. I don't think we concluded—as I recall it, I don't think we concluded the pur-

chase of the hundred thousand. We bought some, but I don't think it ran to that figure, in my memory.

Q. Where you made deposits in Ohio, did you make deposits by particular funds?

A. Yes, in that case I called it to Series D account. That was the series we were selling in Ohio.

Q. But you don't know what happened after the actual deposit?

A. No, I wouldn't recall whether I sent the whole hundred [fol. 1461] thousand or not.

Q. Or if you had sent this one hundred thousand you don't know what liabilities in Ohio would have been secured?

A. Yes, Series D; I am sure of that. As I state in the letter, they were purchased with Series D money.

Q. Mr. Young, you testified that some of the Wisconsin authorities came out to Wheeling in the spring of 1939.

A. Yes.

Q. Do you know just who that was?

A. No, I don't recall the names. It was at the time of the receivership, and there was quite a few people down there.

Q. That was the time when state authorities generally were becoming concerned over the affairs of Fidelity in the respective states?

A. That was the time of the receivership here before Judge Baker.

Q. And did a number of states become concerned over Fidelity's dealings in those states and come down to Wheeling to make inquiries as to the status of the company? [fol. 1462] A. I think several states had representatives down there at that time.

Q. And Wisconsin was one of them?

A. Yes.

Q. Do you know whether that was the first time that anyone from Wisconsin was informed as to how you kept your books, that you kept them by funds?

A. No, I don't think so. They have had access to our records for years, and as I understand it they often had—I say often—every year a representative down there.

Q. Can you tell me whether any representative from Wisconsin prior to the spring of 1939 ever examined or looked at the books of Fidelity with respect to the segregation of liabilities by funds?

A. No, I could not answer that, because I was not in Wheeling.

Q. Isn't it your recollection that in 1939 was the first time anyone in Wisconsin really had any insight into the operation of Fidelity by funds?

A. I wouldn't think so.

Q. I am just asking you if you recall.

[fol. 1463] A. No, they had access to the records and they had representatives down. I should think they knew.

Q. Prior to that time nobody from Wisconsin ever asked you to inform them as to where securities came from or to make any segregation? Am I correct in that?

A. Yes, I don't recall anything before that.

Q. Late in 1940 and early in '41, the State of Wisconsin became quite insistent with respect to the fact that you should get your funds segregated out there? Isn't that correct?

A. Yes, sir.

Q. And during all that time you continued to send securities out to Wisconsin to maintain your deposits there, didn't you?

A. Correct, sir.

Q. And the securities which you would send to Wisconsin were sent in such amounts as would make the total liabilities in Wisconsin not more than ninety per cent of the total securities on deposit in Wisconsin? Isn't that correct?

A. That is correct.

Q. Without regard to funds?

[fol. 1464] A. Without regard to funds, except we did show you the funds the securities went in.

Q. Yes. Now, if you will just answer my question.

A. Well, yes. We kept a liability—I mean our deposits, the market values, up to your requirements.

Q. And that was based upon the fact that the total liabilities on all contracts of whatever series in Wisconsin should not exceed ninety per cent of the total securities on deposit in Wisconsin, whatever their origin.

A. That is correct.

The Court: That is not exactly a correct statement, Mr. Lauritzen, because one hundred and ten per cent of a hundred is a little different from a comparison between a hundred and ninety.

Mr. Lauritzen: The one hundred and ten per cent, Your Honor, is not quite the correct way of expressing it. The actual law is that the liability should not exceed ninety per cent of the amount of the deposit.

Q. And before 1939 and after 1939 you had always sent and continued to send securities to be deposited in Wisconsin on that basis, did you not?

[fol. 1465] A. Yes, to keep the deposit up with the liabilities.

Q. Without regard to segregation of funds.

A. I wouldn't say without regard to segregation of funds, no.

Q. Now you are getting away from my question. I want you to be very definite there. The securities that you sent to Wisconsin were sent out there to keep that deposit in the status so that the total liabilities in Wisconsin on all funds would not exceed ninety per cent of the total deposits in Wisconsin on all funds? Is that not correct?

A. That is correct.

Mr. Lauritzen: All right, sir.

The Court: Let me ask you this. Did you undertake to keep each fund supplied with a hundred per cent for each ninety per cent of liabilities in that fund?

A. Only in a rough way, I would say, because till the computation was made we never knew just what the liability in any fund was in any state and quite often that was sixty days late before it was computed.

Q. Then you tried to keep the separate funds supplied up to the ninety per cent figure?

[fol. 1466] A. Yes.

Q. But as to the surplus that might be in any one fund or might be spread over the whole thing?

A. That is correct.

The Court: That seems to be what he is driving at.

Mr. Lauritzen: I don't think so, Your Honor.

Q. Isn't it a fact, Mr. Young, that before 1939 and after 1939, if you would go and analyze the Wisconsin securities fund by fund, you would find some funds would have a tremendous excess, maybe a million dollars, and some a deficit of two or three hundred thousand dollars? Isn't that correct?

A. That is correct.

Q. But what you did was to maintain in Wisconsin a deposit so that all liabilities of all funds in Wisconsin would

not exceed ninety per cent of all deposits of securities from whatever fund they came?

A. That is correct.

Q. Mr. Young, we had a telegram introduced in evidence here, Exhibit 63, dated February 20, 1941, in which Wisconsin again requested you to allocate your deposit by funds. Did you do it?

[fol. 1467] A. To the extent we were in position to do it.

Q. After that time, when you sent funds out to Wisconsin for deposit on the basis which your have testified you sent them, did you state to the authorities of Wisconsin that those securities came from any particular fund or was to be deposited as security for any particular series?

A. I am not positive whether I did or not.

Q. Now let me show you a letter dated March 24, 1941, signed by yourself, apparently written from your office at 40 Wall Street, New York, addressed to the Banking Commissioner of Wisconsin, and will you tell us whether that is the letter you wrote to the Banking Commissioner of Wisconsin?

A. It is.

Q. And tell us what the purpose of that—how did it come to be written. What were the circumstances?

A. Well, we needed an additional deposit and were requested by the authorities to make such deposit.

Q. And did they say that that deposit was requested for any particular series?

A. I would say not, from memory.

[fol. 1468] Q. And that letter there just says that you are sending them $50,000 worth of securities, doesn't it?

A. That is correct.

Q. And it doesn't say where they came from, does it?

A. No.

Q. And isn't that letter precisely the same type of letter that you always sent to Wisconsin before 1939 and after 1939 in connection with sending the securities out to Wisconsin for deposit?

A. It probably is. I don't recall for sure if they were all alike or not.

Q. Do you know that you ever, on any one occasion, when you sent securities out to Wisconsin for deposit, stated to the authorities of Wisconsin that those securities were securities of any particular Series contract fund?

A. I don't think I did.

Q. Now, there came a time when Wisconsin did find out with respect to securities already deposited from what funds those securities came, did they not?

A. Yes.

[fol. 1469] Q. At lease, you supplied them with information in that regard?

A. Yes.

Q. And that was when you commenced to make these monthly reports, was it?

A. Yes. They had been made quite a little while.

Q. Monthly reports have not been made for over two years, have they?

A. I would say about three years.

Q. About three?

A. Yes.

Q. Since 1939, let's say?

A. I think that is right.

Q. Spring of 1939 when those men from the Banking Commission of Wisconsin came down to Wheeling and talked to you?

A. I am not sure whether they were made before then or not. I didn't have that under my supervision; I don't know.

Q. Did Mr. McNulty make the monthly reports?

A. He handled them all. I don't know who did the physical work.

[fol. 1470] Mr. Lauritzen: You are having those bound, aren't you, Mr. Smith?

Mr. H. Isaiah Smith: Mr. McNulty will be here tomorrow. He will bring them.

Mr. Lauritzen: In 1938 the Banking Commission of Wisconsin conducted an investigation of the Fidelity Investment Association, didn't they, in December, 1938 and maybe extending a little bit into 1939?

A. I am not familiar with that. If it was done it was done in Wheeling in the spring of 1939. I was there.

Q. No, I am thinking of a time when the Manking Commissioner of Wisconsin subpoenaed contract holders and officers of Fidelity in December, 1938.

A. That was just rumor, as far as I was concerned.

Q. You didn't attend any hearings?

A. No.

Q. Do you know who, with the company, is most familiar with those proceedings?

A. I would say Mr. Risley or Mr. McNulty.

Mr. Lauritzen: I would like to have this letter of March 24, 1941, marked if you please.

[fol. 1471] Exhibit 67

The paper referred to was marked as above indicated.

Q. You have identified this letter dated March 24, 1941, addressed by you to the Banking Commissioner of Wisconsin, and we now offer this as Exhibit 67, and that letter is the same kind of letter that you always sent relative to securities deposits?

A. Yes, sir.

Q. And does that hold true for other states than Wisconsin?

A. Yes, they were all just about the same.

Q. In sending securities to any of the states, be it Wisconsin, Illinois, Tennessee, Ohio, Maryland or the rest of them, you never designated the source of those securities with respect to funds?

A. Yes, to some of them, like this one to Ohio a while ago, the Series D fund.

Q. That is one instance. Do you know of any other instance?

A. I wouldn't say I know of them, but I would say there are other instances.

(Witness examines papers.)

[fol. 1472] Q. Do you want to look those over and see if you can reply to the last question?

The Witness: Read the question.

(The question was read.)

A. Yes, Exhibit 60 covered it.

Q. The Illinois letter?

A. The Illinois; and yes again, 64, to Wisconsin.

Q. Isn't it true, Mr. Young, that Exhibit 64 is a statement relative to securities already on deposit with Wisconsin?

A. That is an exchange. I was asking to withdraw the bonds and substitute other bonds in their place.

Q. But the bonds you were substituting in their place, when you sent them out you didn't tell them from what fund they came, did you?

A. (Referring to papers): Well, in your letter here——

Q. You are referring to exhibit number—it is the letter from Mr. Bixby under date of February 28, 1941, addressed to Fidelity Assurance Association for your attention?

A. Yes.

[fol. 1473] Q. All right. What does it say?

A. "At the time we sent you our telegram we stated that we expected the new securities to be received would be allocated to their proper accounts. From your letter of February 21 it appears that this matter of adjustment of the various balances due to the various trust accounts will take considerable time before they are completed."

Q. Will you just read on there?

A. "You ask in your letter if it would be permissible for you to withdraw the excess amount in one account so that this balance could be used in withdrawing securities from other state depositories and then redepositing them in this state to the proper accounts." That was the part I brought out a while ago.

Q. Just read on, please.

A. "I am wondering if it is your intention that when you withdraw this surplus balance from the income reserve account that you will substitute sufficient securities so that the total amount of your deposits now on deposit with this state will not change, as we must at all times maintain the margin [fol. 1474] required by law. It was our understanding, in the letter received from the home office, that this matter of adjustment of various trust accounts would have been completed prior to this date."

Q. So what you did, after the substitution was made, was to send out securities in the same old way, wasn't it, without designating where they came from?

A. No, I think we designated in some instances. I don't recall it. That is pretty far back.

Q. What is the date of that letter you were just reading from?

A. February 28th.

Q. And then here is a letter of March 24th. Don't you suppose that was the deposit made in accordance——

A. I am sure in all instances it was not designated. I think in some it probably was.

Q. You have named two instances, one in a letter to Ohio, one in a certain letter to Illinois?

A. Yes.

Q. You don't know of any instance where it was designated to Wisconsin, do you?

A. Not offhand, no sir. I would have to go through my [fol. 1475] letters; I just don't remember that.

Q. Do you think there were such instances?

A. I think there were such instances.

Q. If you think so, will you look through your records and ascertain for us definitely in that regard?

A. That information will be here in the morning. I would rather see it before hazarding a guess at it.

Q. Mr. Young, I have been asked to inquire of you with respect to this Ohio letter Exhibit 61 whether you don't know it is a fact that you never sent any of those FHA mortgages that you mentioned there to the authorities in Ohio?

A. No, I don't know it is the fact.

Q. You don't know the answer one way or the other?

A. No, I don't recall whether they were sent there or not. It might have been sent to West Virginia.

Mr. Lauritzen: I think I have concluded my examination on these letters. I presume that is all we should cross examine on at this time.

Cross-examination (resumed.)

By Mr. Reinhardt:

Q. Mr. Young, within the limitations of the Wisconsin [fol. 1476] ninety per cent law, what efforts, if any, did you make to allocate Wisconsin deposits by funds?

A. As the money came in from our contract holders, as far as you could in a rough way—For instance, we knew we were not selling the annuity contracts in Wisconsin for a good many years; we were selling the B and A; and as far as practicable we deposited to those two accounts, but not exactly to ninety per cent. That was a figure we would shoot at, but it was sometimes impossible to keep them allocated that way.

Mr. Reinhardt: That is all on this question, Your Honor.

Mr. Lauritzen: Mr. Young, as a matter of fact, you never

got to first base with respect to allocating any funds to Wisconsin by series, did you?

A. Oh, yes.

Q. Don't you know in one series there is a million dollars overplus and in another series some hundreds of thousands of dollars deficiency?

A. Not that much.

Q. You just testified to that a while ago.

A. In Wisconsin?

[fol. 1477] Q. Yes.

A. A million dollars over in one account? Let's see it. We have that right here.

Mr. Ray: It was filed in an exhibit yesterday right here (handing paper to Mr. Lauritzen).

Mr. Lauritzen: Oh, yes. Here we are, Exhibit 55, Mr. Young, apparently reflects the securities deposited and the net cash liability in Wisconsin by funds as of June 6, 1941. If you will look at this you will see that each of the funds is out of balance.

A. Yes, nothing like a million dollars, though.

Q. I understand.

A. For illustration, take our B fund. The market value of securities was $1,577,000, the liability $1,530,000. On the BMR the market value was $287,000 against $221,000. In the annuity account it is short, a market value of $242,000 against $373,000; and the A account was over. Some of them have to be over or you cannot put the amount required to deposit up there.

Q. In other words, in operating under Wisconsin, you just couldn't keep allocated as to funds and still obey the Wisconsin law, could you?

[fol. 1478] A. No, you couldn't do it.

Mr. Lauritzen: All right, sir.

The Witness: No, I wouldn't say you couldn't do that, either, no.

Mr. Huwe: May I ask a question, Your Honor?

The Court: Yes.

Cross-examination.

By Mr. Huwe:

Q. Mr. Young, can you tell us how often you completely changed or substituted securities in Wisconsin or any particular state?

A. There is no certain time; it depends on market values and requirements.

Q. Would you say that you would during a period of three years completely substitute the character?

A. Oh, no.

Q. It would take longer time than that?

A. Take longer time.

Q. When these respective state examiners and officials would come to Wheeling, would they be shown the separate trust fund accounts, and were they aware and did they have notice during the duration of those accounts that they [fol. 1479] were separate trust fund accounts?

A. I couldn't answer that, for I was never in Wheeling when they came.

Q. In your conferences and correspondence with them over the period of time that you were connected with the company, did they evidence a knowledge that there were such trust funds as A, B, C, D, etc.

A. Yes, sir.

Mr. Lauritzen: We object to the use of the term "trust funds" unless you tell us how you are using it and whether you are using it in a legal sense.

The Court: Overruled. That is the term you used in your correspondence.

Mr. Lauritzen: No, sir.

The Court: Well, that is in your telegram.

Mr. Lauritzen: No, sir, I don't believe we used the term "trust funds".

The Court: Look at that telegram and see if he didn't.

Mr. Lauritzen: The Court is correct; "be segregated to individual trust funds in accordance with paragraph four." I am sorry, Your Honor.

[fol. 1480] (The question and answer were read.)

A. I believe all states knew that, for the reason that we qualified in a certain state to sell a certain series, and that state had to be cognizant of the fact that we were selling a different series. For instance, if we were selling A in Illinois, before we could sell B we had to qualify for a different series entirely. I feel the states had knowledge of that.

Mr. Huwe:

Q. So that these respective state officials accepted these securities knowing that they were coming from specific trust funds?

A. I should think so.

Mr. Lauritzen: Now, if the Court please, that is directly contrary to the testimony that Mr. Young has already given He testified time and again that when he sent out the securities, in only two instances that he could name did he ever tell them from what source they came.

Mr. Huwe: When he sends out a letter it is no indication that they don't know those securities are coming from a particular fund. The fact that he doesn't say they are coming from this fund doesn't relieve them of the knowl- [fol. 1481] edge that they are coming from a specific fund.

Mr. Lauritzen: How on earth can they know when all they get is a letter from Mr. Young and some negotiable securities?

The Court: That wasn't all they got. They got reports from time to time; they sent their men down and looked at the books.

Mr. Lauritzen: After the deposits were made, Your Honor, but when the securities came out no one knew where they came from—no one could know.

The Court: Is there a distinction made here now between knowledge at the time they were deposited and knowledge later on?

Mr. Lauritzen: I think that is Mr. Huwe's question.

Mr. Huwe: My question is directed with charging the state officers with knowledge that there are separate trust funds, and when they get a security it is coming from some trust fund, and therefore they are charged with knowledge that the securities belonged to certain funds, although they don't know specifically what fund it is.

[fol. 1482] Mr. Farmer: If the Court please, I object to the generality of counsel's question. If he is trying to show that somebody in particular knew, I think he ought to frame his question in such way as to find out who knew and when he knew, but just to say these states knew, that is not a proper question.

Mr. Huwe: I said "state officials", Mr. Farmer.

The Court: The Court will interpret the evidence in the light of the other facts adduced. I am going to overrule the objection.

Mr. Huwe: I think you have answered that question. There is only one other question. Were you in Wheeling in the spring of '39 when there was a parade of investigators from the various states coming into Wheeling?

A. Yes.

Q. And were you present when some of those investigators or most of them were examining the books?

A. Yes.

Q. Were those men shown in your presence, a separate port folio for each separate fund?

A. I know—I am not sure of the detail they got, but in my conferences with them I know, especially with Wiscon- [fol. 1483] sin, we went over the funds and talked of that very thing, maybe not the individual securities, but whether there was a million dollars liability and a million and a quarter assets or vice versa. That was discussed explicitly.

Q. So that at least the Wisconsin investigator and those others that were present—do you remember what other states were present at that time?

A. No, I don't. As you said, there was a parade.

Q. At least those officers knew that there were separate trust funds and securities belonging to separate trust funds, and that the cash payments were put into such port folios and separately held?

A. Correct.

Q. You were not present at earlier investigations of that type?

A. No, I was not.

Q. But you do know from your general relationship with these officials since '32 when you first became connected with the company, that they were aware of the existence of the different funds?

A. Yes, as I say, every time we registered a contract they [fol. 1484] had to know what that contract was.

Mr. Lauritzen: Just a moment on your last answer, Mr. Young. You told me a moment ago, didn't you, that you didn't know of anybody from the State of Wisconsin who, prior to 1939, came in and looked at the books of Fidelity

and ascertained whether or not the accounts were kept by funds or how they were kept?

A. We were talking about '39 now.

Mr. Lauritzen: Read my question.

(The question and answer were read.)

A. And would know they were a different series entirely.

Q. Since 1932 or 1939?

A. I think that has gone on ever since there has been a company.

Q. You just told me a minute ago that you didn't know, up to the time the Wisconsin men came out in the spring of 1939, that any man from Wisconsin had ever looked into Fidelity's books to find out how they were kept as to funds or any other particulars.

The Court: Mr. Lauritzen, he is explaining to you that he is basing his answer to the last question of Mr. Huwe on [fol. 1485] the fact that the contract itself says that a trust fund is set up as a reserve for that particular class of contracts. This is argumentative, of course, but nevertheless that is his testimony, that that being on the contract, and the contract exhibited to the state official, that they must have knowledge of it.

Mr. Farmer:

Q. Mr. Young, are you familiar with the descriptive booklet with respect to these Series B contracts that the company got out in 1939 or 1940?

A. I have seen it. I wouldn't say that I am especially familiar with it. Naturally I have seen it.

Q. Was that sent to these various state department officials?

A. I don't know that. I didn't handle that at all. I presume it was, but I don't know.

Q. You don't know what use was made of that?

A. Yes, I know this. Every contract holder you approached after this date must be shown the prospectus.

Q. You say every contract holder who was sold a contract of Series B must be shown this descriptive booklet?

A. It was presumed the salesman, in presenting it, would [fol. 1486] show him that booklet.

Q. It was presumed, you say?

A. Yes.

Q. Was it sent out with instructions to the salesmen to show it to them?

A. That wasn't in my department.

Q. Whose department was that?

A. That was in the sales agency division, which I had nothing to do with whatsoever.

Q. They provide a receipt for the contract holder to sign acknowledging that he has received this booklet, don't they?

A. I think so, yes.

Q. Was that prepared under the directions of the Securities and Exchange Commission after that injunction was granted in the suit in Detroit?

A. I wouldn't say it was prepared under their supervision. I think it was requested that we change our form of statement, and to that extent I am sure they had supervision of it.

Q. Do you know who handled the preparation of the booklet for your company, who worked up the figures and state-
[fol. 1487] ments that went into it?

A. I think the auditors, Haskins and Sells.

Q. And what officials of your company?

A. I don't know. That was done in Wheeling, and I am not there anyhow.

Q. Were you familiar with the fact that this balance sheet in this booklet showing the investment of the reserves of Series B contracts contained this explanation or statement, "The securities deposited with state authorities are subject to the requirements of the states with respect to all the contract funds of Fidelity Investment Association, and are not necessarily held for the sole benefit of the holders of these particular contracts. In this connection reference is made to the foreword of this report"—were you familiar with that representation that went out?

A. I don't recall it.

Mr. Ray: What is this booklet? Hadn't you better put it in evidence?

Mr. Lauritzen: I believe Mr. Isaiah Smith has arranged for a supply of these booklets to come down here tomorrow, and we can introduce it in evidence at that time.

[fol. 1488] Mr. Schurr: I have to return that to the Insurance Commissioner of the State of Missouri. I can't leave that here.

Mr. Ray: They are asking a lot of questions of this witness about a booklet the witness hasn't even seen, and which is not in evidence.

The Witness: I have seen it.

The Court: I don't believe there is any use asking questions about that. He said he doesn't know anything about it.

The Witness: I had nothing to do with compiling it whatsoever.

Mr. Farmer: Is this statement correct: "The investments of reserve funds, unmatured contracts and maturity and retirement reserve fund include securities which were transferred in 1933, 1934, 1935, and 1937 from other funds of Fidelity Investment Association at market values, which were $23,553.61 more and $1,542.31 less, respectively, than the cost when originally acquired by any of the funds." Is that statement correct?

A. I presume it is. Haskins and Sells edited it; I would presume it is correct.

[fol. 1489] Q. Did they get that from your records about the switching of these securities?

A. It went through our accounts, of course, at Wheeling. When they checked it they would have to get that; they couldn't miss it.

Q. You are familiar with that part of it?

A. Yes, sir.

Q. That related to your particular duties, didn't it?

A. Yes, sir. I don't recall the amount, but I know——

Q. And you know it is a fact that in 1933, 1934, 1935 and 1937 securities were transferred from other funds?

A. Yes.

Mr. Farmer: We want to ask some more about this after somebody gets on the stand that is more familiar with it.

Q. Did you tell me who would be the man that was most familiar with this booklet and the use that was made of it and the preparation of it and getting the approval of the SEC, and all that?

A. Well, of the present staff I would say Mr. McNulty.

[fol. 1490] Mr. Reinhardt: For the record, I want to say that the SEC did not approve this pamphlet,

Mr. Farmer: I think the witness said they did.

A. No, I didn't say that.

Mr. Farmer: I misunderstood him.

Q. You said, as I caught you, Mr. Young, that you believed that there were some statements of some sort to Tennessee officials, the Insurance Commissioner, showing some segregation of securities by these different funds?

A. Yes, sir, monthly it did. Whether each specific shipment called attention to the accounts I don't remember, but they got a monthly statement that did.

Q. The Tennessee department did?

A. Yes.

Q. Do you know that of your own knowledge?

A. No, I didn't send them out, but I had copies.

Q. Who would send them out?

A. It comes from the Wheeling office. I don't know who had the supervision of that.

Q. Who was the man who could say they were sent or not sent?

[fol. 1491] A. I would say Mr. McNulty.

Q. So you don't know of your own knowledge?

A. No.

Q. So far as you know of your own knowledge, you never told the department in Tennessee that there was any separation of any of them.

A. No, I don't think I did.

Mr. Farmer: That is all.

Cross-examination.

Mr. Reinhardt:

Q. Mr. Young, when you got copies of these monthly statements from the Wheeling office, was there any indication of the use they had been put to?

A. I don't think it indicated, but it was always understood they were gotten up for the particular purpose of informing the states. That was the reason they were compiled, so we would all be familiar with the deposits and the other information that was necessary.

Q. As to the statement in this pamphlet that there had been a transfer of securities from one fund to another, do you know what that refers to?

A. Oh, there was quite a number of transactions in that [fol. 1492] category.

Q. Were they sales from one fund to another?

A. They were sales from one account to the other, which prevented a physical transfer of the securities.

Q. You mean that these funds were so far regarded as independent entities by the company that one fund sold securities and bought securities from another fund?

A. Yes, they were always segregated that way.

Mr. Palmer: I will ask you whether you will develop that by showing whether there was actual selling and buying, or just a book transaction on Fidelity's books. I think the Court would like to know that.

Mr. Jaegerman: I think we can develop that, Your Honor, in the general history of the workings of this company.

The Court: All right.

Mr. Jaegerman: And I believe it would be easier to start with one fund and see how one fund works.

Mr. Palmer: Before you start, may I ask Mr. Young one question with reference to the examination that has gone on today?

Q. Do you know when Series B contracts were first [fol. 1493] sold?

A. 1934, I think.

Q. Up until that time had there been any segregation of funds in the various states?

A. On our records, yes.

Q. Isn't it a fact that Mr. Sims, the State Auditor of West Virginia, required you to put into your Series B contracts a provision that the moneys received by the company from the contract holders of that contract, would be held by the company separate and apart from all other funds?

A. Yes.

Q. And wasn't that the first time you had any such provision in your contract?

A. The first to my knowledge.

Mr. Palmer: I don't want to give up my right of cross-examination, but I wanted that one point in connection with this present point.

Cross-examination.

By Mr. Jaegerman:

Q. Mr. Young, that was a question of terminology and wording, was it not, and the practice of the company has

[fols. 1494-1508] been to set up this segregation according to its understanding of prior contracts.

Mr. Palmer: What does the corporation understand about the wording of contracts? Can't we speak of individuals?

Mr. Jaegerman: A corporation acts through individuals, Mr. Palmer.

The Court: Go ahead.

The Witness: I would like to have the question read.

(The question was read.)

Mr. Jaegerman: Its understanding, or as the corporation had been advised by its attorneys.

A. Yes.

* * * * * * *

[fol. 1509] Q. Now, let us take the State of Missouri, for instance. How many times a year would you receive reports that there were liabilities of the company to contract holders in Missouri and that you would be required to make a deposit of funds in Missouri?

A. As I said, for the last three years they came in monthly, as I recall it, in Missouri.

Q. How about before that?

A. It came in periodically. I don't think it came in over about twice a year, as I recall it.

Q. In the last three years——

A. Four years—three or four years.

Q. The last three or four years, did you receive a report as to the liabilities of every state monthly?

A. No, I did not.

Q. Which states did you receive monthly, or was that spasmodic?

A. I received monthly Wisconsin, Illinois, Missouri, Alabama——

Q. West Virginia?

A. I am not sure whether I got West Virginia monthly or not.

Q. Do you recall any others than those you have men-
[fol. 1510] tioned?

A. Tennessee.

Q. As to the other states in which deposits were required, how frequently or infrequently did you receive reports of the liabilities there which required deposits?

A. An average of twice a year.

Q. An average of twice a year. And that included West Virginia?

A. Yes.

Q. How frequently did you receive reports that liabilities in the various states in which there were deposits had matured and that you could ask for a withdrawal of funds?

A. I never received such a report.

Q. Who took care of the withdrawing of funds when liabilities matured?

A. Of the various states?

Q. Yes.

A. Well, in practically all cases our liabilities were increasing at the same time so there were practically no withdrawals.

Q. That is just what I want to get at. So long as you continued each year—by "you" I mean the company—to sell more contracts in amount than liabilities accrued, you [fol. 1511] didn't bother to make withdrawals, isn't that right?

A. Well, in some states we couldn't, because our deposit was deficient of the amount.

Q. My point is this, that if in a given state you had maturities of $50,000 cash value a year and liabilities of $100,000 cash value a year, your practice was merely to deposit an additional fifty thousand a year and not otherwise disturb the fund. Isn't that correct?

A. Yes, in proportion as we could; not always exact, as I said before. That was the principle.

Q. Yes, that was the principle of it. So that under that practice it was impossible for you yourself to try to determine for each series an amount that became due by maturity whereby you could have release of funds and replace that as a new deposit when new liabilities occurred? Isn't that correct?

The Witness: Read that question, please.

(The question was read.)

Mr. Ray: Your Honor, we object to the use of the word "impossible" in that question.

The Court: I will overrule the objection.

A. In that case it was not necessary for me to know the maturities, because, as I say, I was given the additional

[fol. 1512] liability and it was not of interest to me when the maturities came especially, because the cash as it came in was allocated to that particular contract or series and the cash was there for maturities. It was no interest to me how they matured; it was of interest to me what the total liability was.

Mr. Palmer:

Q. My question was that so far as you personally were concerned, it was impossible for you to determine the amount of liability that matured in a given state and have those funds released and then when a new liability was incurred, to substitute those or other funds for that. Isn't that correct?

A. No.

Mr. Jaegerman: Your Honor, may I renew the objection to that question as framed? The witness has already testified it was unnecessary for him to do that. I don't see how the question of possibility would arise.

The Court: Well, that is only a matter of opinion whether it was necessary or not. I will overrule the objection.

A. It was not impossible. All I had to do was to request Wheeling, if I wanted it, and I would have it in thirty or forty days.

[fol. 1513] Mr. Palmer:

Q. Then you could have requested Wheeling to furnish you with the amount of maturing liability in each state?

A. Certainly.

Q. Did you ever request them?

A. Yes, numbers of times.

Q. Did you request them periodically?

A. No, not periodically. I would request them when I thought it was important for me to have it.

Q. To have that information?

A. To have that information.

Q. How long did it take to obtain the information?

A. Well, it depended on how much work they had to do in the Wheeling office. I would say an average of about thirty days, as I told you before; it took about thirty days to work those reports up.

Q. Would the various state depositories when, say the maturity had arrived for contract holders in the special income series for which there had been a deposit made—when those contract holders had been paid off, would the various states release the funds to you which were deposited as security for that special income series contracts?

[fol. 1514] A. That has been done, yes.

Q. And has it been refused?

A. Not when we had sufficient on deposit. I don't think it ever has.

Q. What do you mean "when you had sufficient on deposit"?

A. When the assets equalled or exceeded the liabilities.

Q. The total of all contracts? Is that correct?

A. Yes.

Q. What I am trying to get at is this: If you had paid out certain contracts at their maturity and wanted to withdraw the deposits which had been made on your books for that particular fund with a given state, were you permitted to do so unless there was a sufficient deposit in the state whereby all liabilities were covered by the total fund on deposit?

A. Yes.

Q. You were permitted to withdraw it?

A. Yes.

Q. In what state were you?

A. By making substitutions.

[fol. 1515] Q. Oh, yes, but I say, were you permitted to withdraw it absolutely and leave that fund in its current shape although other funds might have been under?

A. Well, I don't recall attempting that except in West Virginia.

Q. You never attempted that in any state?

A. I don't recall attempting it.

Q. So that, then, you were not attempting to keep these funds in the states by series, the deposits in back of them, were you?

A. Yes, that is not—that is not the situation. The older accounts the deposit had not been sustained due to market drops for several years, so they had been under water in most of the states for quite some time, and knowing they were, we certainly would not request the state to give them up.

Q. Was that true in every state that the older series of deposit that you had on your books for it were under water?

A. I wouldn't say all of them. I don't recall just which ones, but several of the larger ones were.

Q. Well, your special income series has been maturing over the last seven or eight years, has it not?

[fol. 1516] A. Yes.

Q. And you have been paying out on it over the last seven or eight years?

A. Yes.

Q. In fact, if it had not been for re-dates, and so forth, it should have all been paid up in 1936, isn't that right?

A. I wouldn't answer that; I don't know.

Mr. Jaegerman: Your Honor, may I ask the counsel to bring out in what states special income contracts——

Mr. Palmer: You bring it out.

Mr. Jaegerman: They were only sold in West Virginia, Pennsylvania, Indiana, and the District of Columbia.

Mr. Palmer:

Q. In any of those states Mr. Jaegerman has mentioned, did you ever withdraw any funds which had been deposited as security for the special income series?

A. I don't recall. For instance, the District of Columbia, we had no deposit. In Pennsylvania, we had a very small deposit. We were required to put up a hundred thousand, as I remember, when we went in there. So there was nothing to recall.

Q. Did you recall it?

[fol. 1517] A. I say, I don't recall any.

Q. The special annuity series, has it been maturing?

A. Yes, the last few years.

Mr. Palmer: In what states was it sold? Perhaps Mr. Jaegerman can tell us.

The Witness: I haven't it before me.

Mr. Jaegerman: That was sold in Illinois, Pennsylvania, West Virginia, Ohio, Michigan, Indiana, District of Columbia, Kansas, Virginia, Maryland, Tennessee, Missouri, Oklahoma, Florida, Connecticut, Kentucky, Delaware, New Jersey, Mississippi, Minnesota, North Dakota, South Dakota, Arkansas, Iowa, North Carolina, and Alabama.

The Court: Did you get all of those, Mr. Palmer?

Mr. Palmer: Yes, sir. I am asking the witness to keep them in mind.

Q. Mr. Young, can you name any of those states in which, by virtue of having paid to a contract holder his matured contract, you so advised the depository in that state and withdrew funds because you had paid up the matured contracts?

A. Yes, we withdrew funds from Illinois.

Q. In what year?

A. '34 I think it was.

[fol. 1518] Q. Under what circumstances did you withdraw the funds?

A. Under the circumstances we had more there than was required under the special contract—annuity contract, as I recall it.

Q. Did you also have more on all of your assets than you did your liabilities?

A. In Illinois?

Q. Yes, at that time.

A. At that time we were, according to the requirements—the requirements were made July 7th, 1931 and we did have considerably more and I withdrew, as I recall it, some $300,000.

Q. And that was the reason you were permitted to withdraw it and not because you had paid up your special annuity contracts?

A. That is why we had the excess, because we had been paying up.

Q. When did the special annuity contracts first mature?

A. I couldn't answer that.

Q. Can you give me some approximate date?

A. Let me see. I would say they started maturing in '34 or '5, I think it was.

[fol. 1519] Q. And when did you first start paying up on them?

A. First learn of it?

Q. When did you first start paying on these matured contracts? In '34 or '5?

A. I think that is correct, a very small volume then. There was no large volume of matured contracts and annuities till the last three years.

Q. Then the deposit that you withdrew in 1934 in Illinois could not have been because you paid up on your special

annuity contracts, if you didn't start maturing them until '34 or '35?

A. We had cash surrenders, though.

The Court: Mr. Palmer, all this line of questions that you are propounding seems to me to be directed at a subject that is just as clear as it can be in the Court's mind without the necessity of all the questions and that is that it is plain that in states which required deposits to equal a certain percentage, a hundred per cent or one hundred and ten or whatever it might be, of all liabilities that the debtor here would not have been permitted to withdraw a surplus in a particular fund if there was a deficiency in another fund that more than equalled that surplus. That seems to me [fols. 1520-1528] to be as plain as the nose on your face without the necessity of long examination.

* * * * * * *

[fol. 1529] Q. Now, I believe you said that Fidelity tried and couldn't qualify under the Investment *Trust* Act of 1940?

A. I don't think they tried.

Q. Beg your pardon?

A. I say, to my knowledge, it was not tried.

Q. By legal investigation and financial investigation and so forth, it was determined it was impossible for them to comply?

A. It was concluded, as I understood it, that we could not comply without additional capital.

Mr. Jaegerman: Your Honor, I object to that question, because I believe the record shows Fidelity did comply with the Investment Act of 1940.

[fol. 1530] The Court: Did?

Mr. Jaegerman: Yes, they filed this notification as required by that Act.

Mr. Palmer: And it was licensed by the S. E. C.?

Mr. Jaegerman: The S. E. C. doesn't license any company.

Mr. Palmer: You mean that Fidelity was permitted under the Investment Act of 1940 to go on and operate by the S. E. C.?

Mr. Jaegerman: I believe that is true.

Mr. Farmer: If the Court please, I believe the gentleman ought to be able to make an accurate statement about that. Surely the gentleman doesn't mean what he says.

Mr. Reinhardt: I think Mr. Jaegerman means exactly what he says. I think perhaps counsel has something else in mind.

Mr. Palmer: Why not let Mr. Jaegerman say what he meant——

The Court: Let's have one at a time and proceed in an orderly way. Mr. Jaegerman, do you have a statement to make?

Mr. Jaegerman: If Mr. Palmer means that under the Act they were not permitted to make a new sale, I understand that is correct, but that certainly does not mean they were [fol. 1531] not permitted to remain in business.

Mr. Palmer: Your position is they were permitted to carry on their old business but not to engage in the business of selling annuity contracts such as they had been? Is that correct?

Mr. Jaegerman: The Act states certain requirements as to the contents of any new contract Fidelity might sell and under the terms of the Act, it couldn't sell the contract it had been selling.

Mr. Palmer: I think that is what Mr. Young and I both understood when I asked him and he told me that they couldn't comply with the Investment Act of 1940. Isn't that right, Mr. Young?

A. I said I wasn't entirely familiar with it, but we didn't think we could get a contract under it at that time that would be profitable and salable.

Q. And that is what you understood when we were talking about the compliance with the Act or failing to comply, is that correct?

A. That is correct.

Mr. Farmer: I just want to ask Mr. Jaegerman if he would state that this company never became a registered [fol. 1532] company under the Investment Act of 1940.

Mr. Jaegerman: I have already stated that it did file its notification under the Investment Company Act.

Mr. Farmer: That wasn't my question. Did it become a registered company under the Investment Act of 1940?

Mr. Jaegerman: I don't know what you mean by it becoming a registered company.

Mr. Farmer: Are you familiar with the definition of "registered Company" under that Act?

Mr. Jaegerman: Yes.

The Court: Let's see if the Court understands what happened. After the passage of the Investment Company Act of 1940, the character of the Fidelity contract as then written was such that it could not be sold in compliance with that Act?

Mr. Jaegerman: That is right, your Honor.

The Court: And therefore it had to quit selling those contracts, and that is the extent to which the Investment Company Act applied to this business?

Mr. Jaegerman: One thing further: Under the Act, if they were to use the mails in interstate commerce, they would have to file notification—that would apply to its [fol. 1533] old business—and they so filed notification.

The Court: So that it is not an opinion question yet whether or not the Fidelity Company, by producing a new form of contract which would comply with the Act, would be permitted to do business?

Mr. Jaegerman: That is right, your Honor.

The Court: All right.

Mr. Palmer:

Q. Mr. Young, did you and the others of Fidelity attempt to produce a new contract or attempt to look into whether or not a new contract could be produced by which you could make any money and which would comply with the Investment Company Act?

A. I did not. That was entirely outside of my activities.

Q. You advised with those, however, as to what financial return they could get on the type of investments they would make, did you not?

A. Yes, I did.

Q. And was it not determined, to your knowledge, that the company could not produce a contract on which they could make money at the return allowed by the Act and in the type of security in which they would have to invest?

[fol. 1534] A. No, that was not determined.

Q. What was determined?

A. It was only determined, as I understand—as I say, it was entirely out of my activities—but that the contract or the yield that we were allowed to give to the contract holder—not allowed to earn ourselves, but to give—was not sufficient to make it attractive to the purchaser and allow the necessary loading for expenses.

Q. And that still holds, doesn't it?

A. I presume so.

Q. You stated it was your opinion that while it could not, therefore, qualify under the Investment Company Act, the company could and should be rehabilitated, first that it could be rehabilitated as a mutual life insurance company, with the contract holders to become the owners of the company?

A. I did not state that in my opinion it could not register as a face amount contract company. I think changes can be made to where it could.

Q. Let's get to this question. You stated that you thought it could be rehabilitated as a mutual life insurance company?

[fol. 1535] A. In my opinion it could.

Q. And that would be where the contract holders would be the owners of it?

A. That is correct.

Q. The present stockholders would have no equity left?

A. No, none.

The Court: They haven't any now, have they, Mr. Young?

A. I would say not.

Mr. Palmer:

Q. And it would be necessary that this company qualified to do business under the life insurance laws of each state wherein it went to do business?

A. I presume it would. I am not familiar with that; I have not gone into it; I presume they would.

Q. Can you tell me whether those persons in charge of life insurance in each state are the same persons who were in charge of the annuity companies with which you did business?

A. As a general thing they are, I am sure.

Q. Now, you next said that it could be reorganized as a face amount security company with new capital, is that correct?

A. Well, I didn't—I have not prepared a plan for the reorganization of the company, but in my opinion, some-

[fol. 1536] thing on that order could be done. It could be merged with another company or absorbed by another company which has additional capital.

Q. Do you think that this particular company can be rehabilitated in itself so as to sell face amount certificates and make money in view of the Investment Company Act of 1940?

A. Yes, I think it could.

Q. And why couldn't the old company do it?

A. Because you have to make a lot of changes; you have to cut down an awful lot of expense, but it could be done.

Q. Didn't you just say that you were not able, in the old company, to make a new contract whereby you could make money and still carry the loading and still give the investors anything that would be attractive to them?

A. I am not so sure that is the case. I had nothing to do with that conclusion. I am not so sure in my mind that that is the case. Other people are doing it.

The Court: By the changes you speak of, do you refer, perhaps, to a scaling down of loading or some other feature that would render the expense of selling the contracts [fols. 1537-1538] less and thereby increase the profits?

A: I think that there would have to be a contribution made by the contract holders of the various series and especially the ones that are insolvent, and that the others should be asked to reduce the required amount presently required to redeem them.

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[fol. 1539] Q. With the exception of West Virginia, you would have to comply with state laws in every other state?

A. That we attempted to do business in, yes.

Q. And those laws are much more rigid?

A. Some of them are; some of them are not.

Q. Wisconsin is?

A. Much more rigid.

Q. Illinois is?

A. Not very much more.

Q. What others are more rigid?

(No answer.)

Q. Iowa?

A. No.

Q. New York?

A. We don't attempt to do business in New York with this company; never have. Wisconsin is the only one that

is much more severe than West Virginia laws, and I will say this—I am not sure of this, but I am of the opinion [fols. 1540-1545] that the insurance requirements in Wisconsin are not as severe as the ones we are at present operating under.

. . . . . .

[fol. 1546] Mr. Palmer:

Q. In Wisconsin there are certain liabilities to the contract holders by virtue of their contracts for payment to them of cash amounts. Is that correct?

A. As set out in their contracts.

Q. And there are sufficient funds in Wisconsin to pay every dollar of that liability as set out in the contract, one hundred cents on the dollar, is that correct?

A. I think we have a legal question there, due to the segregation of the funds.

Q. Well, isn't there enough money to pay every single one a hundred cents on the dollar?

A. You are presuming, of course, it is all thrown into [fol. 1547] one hopper?

Q. That is right.

A. There is, I think.

Q. The figures show it, don't they?

A. Yes.

Q. In Illinois is there enough money, as shown by the figures, to pay back every contract holder who has an asset in that state the amount of liability owed to him by virtue of his contract a hundred cents on the dollar?

A. No, sir.

Q. Then the State of Wisconsin, with its stringent requirements, protected its contract holders a hundred per cent, didn't it?

A. That comparison is not necessarily correct, because we were not required in Illinois to keep a deposit up to July 7th 1931. From then on, from July 7th 1931, there was ample money to pay all liabilities in Illinois.

Q. Don't you believe, in your opinion as a financial expert, that every single state in which you, as a new company, would attempt to do business as a face amount security company, is now going to see that that company puts up enough so that its people get back a hundred cents [fol. 1548] on the dollar, the same as Wisconsin?

A. Take Illinois again. As soon as it passed the Legislature, we were forced to have a market value there equal to our reserve liabilities in that state, and that has been going on since 1931. If it wasn't, we were called on for another deposit and it was sent out.

Q. You don't have enough in Illinois?

A. After we were required to have it, yes. We do from July 7th 1931.

Q. Before that you didn't have?

A. We were not required to have.

Q. All right. Now, isn't it your opinion that every state, before a new company will be permitted to do business on face amount securities, that state is going to require that they are going to be protected a hundred cents on the dollar for contract holders in that state from now on?

A. That is perfectly all right, if you don't have to protect them with Government bonds.

Q. Aren't they going to find out why Wisconsin is fully protected and Illinois is not fully protected at present and adopt the Wisconsin idea, so they will get fully protected?

[fol. 1549] A. Maybe they will.

Q. And they if they do your new company can't do business?

A. If you have additional capital you can make up that ten per cent.

Q. Can you still make money?

A. That doesn't mean, as I understand, that they have the same regulations as Wisconsin.

Q. If it is the only one that gets its money back in full you can bet they will, can't you?

A. I don't think so.

The Court: You seem to lose sight of the fact that Mr. Young's distinction is that Wisconsin required securities that gave an extremely low yield, and thereby protected the contract holders in Wisconsin at the expense of the contract holders all over the United States. He says that the requirement in Illinois permitted investment in securities that yielded almost twice as much as the ones in Wisconsin.

The Witness: One and a half points more.

The Court: I thought he said in some cases he got as much as two per cent higher than he did in Wisconsin.

[fol. 1550] The Witness: That is correct.

The Court: And that is a matter you ought to take into consideration, in your question.

Mr. Palmer: I think, Your Honor, the point I am trying to bring out, that Wisconsin required such a high grade security that there wouldn't be the fluctuation that there would be in securities in Illinois, which paid a higher rate of interest, which he classified as semi-speculative.

The Witness: So long as the market value is maintained it doesn't make any difference whether it is a government, a good corporate bond or a municipal.

Mr. Palmer:

Q. But you have a lag, I believe you said, of at least thirty days?

A. That is right.

Q. And in that time the market can break so badly you won't be able to buy the good securities.

A. Not hardly. You can anticipate as bad a break as that, I think.

Q. No one has ever anticipated these bad breaks before, have they?

A. Yes, they have.

[fol. 1551] Q. Did you anticipate them?

A. Yes, sir.

Q. Why didn't you advise Fidelity in 1937 to take it in cash?

A. I did.

Q. In writing?

A. I have a memorandum that we get out of speculative bonds, and just about the time we started the bottom just dropped out, and it would have been very foolish to continue that program.

Q. Then in the lapse or the lag, with as much money as you have, you can't get out necessarily and get in good securities to take the place of speculative ones?

A. All right. I will say all through that lag Illinois was protected a hundred per cent. It is in the regulations of 1931.

Q. Are they protected as to the liabilities?

A. From the beginning of business? No, we were not required to do it until recently, and then we couldn't do it.

Q. You say that Fidelity had speculative securities in 1937?

[fol. 1552] A. I would say semi-speculative, as I said a while ago.

Q. Didn't you just tell them that you advised them to sell their speculative securities?

A. If you want to be that technical, yes; yes, sir.

Q. I want to be as technical as the words you used.

A. I would say semi-speculative instead of speculative. Everybody has got a list of the bonds anyway, and know what we have.

Q. So that we can get a definition, tell us what a speculative, semi-speculative and conservative security is.

A. I can't make the definition.

Q. Who can?

A. I don't know.

Q. How do you know one from the other?

A. Because it is just a feeling by your knowledge and your contact with the business you have to get an idea whether a bond is speculative or not. If it is a corporate bond you have got to go into the management of the corporation, you have got to see if their business is volatile [fol. 1553] enough—there are so many things that make a bond speculative or not speculative. It is not the things that Moody and Standard give them, in my opinion. Statistical companies attempt to show speculative bonds and non speculative bonds, and so forth. They go by the market price of the bonds.

Q. Who does that?

A. Moody's and Standard's. I have seen many instances like this, where a bond is put a speculative group selling at sixty, they say, "Don't buy, or sell;" if it gets up to seventy-five, the same security, they advise you to buy. So I don't think there is any real definition for it.

Q. If a bond with a par value of a hundred dollars is selling at a hundred dollars, is that considered by you to be speculative, semi-speculative or conservative?

A. Not necessary. I would have to know what the bond was.

Q. If a bond was selling at ten, with a par value of a hundred dollars, you wouldn't know whether to call that conservative, semi-speculative or speculative until you investigated it?

[fol. 1554] A. I think I would call that practically worthless.

Q. Let's get up to a bond selling at fifty, with a par value of a hundred, what is that? Is that worthless, half worthless, or what?

A. I say you have to take each individual bond. As a class, I would say it is a speculative bond, of course.

Q. Were speculative bonds what you were attempting to advise Fidelity to buy, or higher type, conservative investments?

A. We had both.

Q. Which were you advising them to buy?

A. Over the period of years?

Q. Yes.

A. I was buying largely under the rules we were operating under.

Q. Which were you attempting to buy, a speculative, semi-speculative or conservative—you yourself?

A. Both.

Q. Were you advising Fidelity to buy speculative bonds?

A. Yes, I did in certain instances—sure I did.

[fols. 1555-1572] Q. In other words, speculation means you hope the bond will be good and you can make money on it?

A. Yes.

Q. And yet you want other people to allow you to gamble in that fashion with their money by forming a new company?

A. No, that is entirely different. The speculative bonds we bought were in the accounts that were under water. We did it with the hope of making some of that money back. In a new company you have a different problem.

Q. If I understand that, you did it in accounts that were already in the hole, in the hope of gambling to get them back up.

A. I didn't want them to gamble, sir. A speculative bond does not necessarily mean you are gambling; it means you have hopes of it going up, but it don't mean that you have to sell it if it goes down and take a loss.

Q. But there is a bigger chance of it going down than a semi-speculative bond?

A. It depends on the market entirely.

* * * * * * *

[fols. 1573-1579] Mr. Huwe:

Q. Mr. Young, with reference to your testimony this morning concerning the practice of withdrawing, or, shall I say, balancing particular funds, deposits and liabilities, in each state, I would like to ask you if, when your company followed the practice of not withdrawing any securities belonging to a particular fund from a state deposit, even though that particular fund's liability was reduced, when such withdrawal would reduce the total state deposit below the total state liability, isn't it a fact your company was prevented from carrying out its obligations with respect to the balancing of each fund's deposit and liability in each state by the state laws?

A. Yes.

* * * * * * *

[fol. 1580] Q. Investors' Syndicate is one of your main competitors, is it not?

A. Yes, they are the largest comparable company in the field.

Q. It has recently incorporated a new company or new organization under the investment companies act of 1940, [fols. 1581-1591] has it not?

A. So I understand, yes.

Q. As such new company, has it qualified and is it doing business in the State of West Virginia? Do you know?

A. I don't know.

Q. You wouldn't be able to state whether it is doing business now in West Virginia under the new corporation or whether it is doing business in Wisconsin, Illinois, Tennessee, and other states?

A. I have no idea.

* * * * * * *

[fol. 1592] Q. Mr. Young, with respect to securities generally, in a time of inflation or an ascending market, what is the effect of such a situation as between extremely high grade bonds and second grade or lower grade bonds and equity securities?

A. In times of inflation?

Q. Inflation.

A. Well, the economic history shows that in time of inflation the high grade bonds go down and the second grade bonds follow equities and come up; but we are not in ordi-

nary times, so no one, I don't think, can forecast now just what will happen.

Q. But the experience of the past would teach that?

A. The experience of the past would teach that. That is the case during inflationary periods, which we have had very few, I think, in my recollection.

Q. With respect to the securities you have on deposit, [fol. 1593-1610] those are what you would term the highest grade of bonds, are they not?

A. You mean in Wisconsin?

Q. Yes.

A. Yes.

Q. So that assuming that we might have a period of increasing prices, the possibilities are that the securities you have got in Wisconsin would probably go down rather than go up. Am I correct in that?

A. It is possible, but I hardly think it is probable to any extent, due to unusual circumstances.

Q. You don't think the securities in Wisconsin will go up to any appreciable extent, do you?

A. No, I do not.

* * * * * * *

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[fol. 1611] J. H. SCHELLHASE, recalled as a witness on behalf of the debtor, testified as follows:

* * * * * * *

[fol. 1612] Mr. Fleming:

Q. I will ask you to refer to debtor's Exhibit 69 and state whether or not that was prepared by you.

A. Yes, it was prepared by me.

Q. Would you explain that to the Court, if you will, please.

Mr. Lauritzen: Is this the paper that is in evidence already?

Mr. Fleming: No, this is a compilation giving a breakdown of the income of Fidelity, the various sources of income, for the year October 31st, 1939 to October 31st, 1940.

Mr. Lauritzen: Is it by funds or overall?

The Witness: It is by funds—the gross income by [fols. 1613-1635] funds taken from the audit report of Haskins and Sells.

Mr. Fleming:

Q. You may proceed, Mr. Schellhase, and explain the exhibits.

A. Of course, this schedule shows the interest on investments, the dividends on stock, rent from real estate, profit from disposal of investment securities, interest on interfund loans, interest on loans to contract holders, interest on past due collections, gain from surrender of contracts, underwriting fees and commissions earned, and participation in surplus earnings of contract funds, miscellaneous income. A gross income of $1,630,173.09.

As of today, of course, some of this income we are not receiving, like the loading from contract payments and so on, which we were in 1940; so I have eliminated some of those items, and it gives you a net total of gross income, after eliminations, of $1,061,460.37.

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[fol. 1636-1639] By Mr. Farmer:

Q. Your compilation here, Mr. Schellhase, is taken from a figure set out in Haskins and Sells' audit report filed as Exhibit 14 in this case?

A. That is correct.

Q. That audit report contains a statement of income for the year ended October 31, 1940 for each of these special funds and for the general fund, does it not?

A. That is correct.

• • • • • • •

[fols. 1640-1647] Q. The next is the general fund and agency division. Does that show a net loss of $196,021.10?

A. That is correct.

Q. And no provision was made during the year for federal income taxes?

A. That is correct.

• • • • • • •

[fol. 1648] Q. Mr. Schellhase, what are the most recent series of face amount contracts or certificates that have been issued and sold by Fidelity?

A. The Series B and the Series D contracts.

Q. Which of these accounted for the largest volume of business?

A. The Series B.

Q. When was the Series B contract issued and sold?

A. It was issued and sold from June 15 to December 31, 1940.

Q. In how many states was this series of contracts sold?

A. In approximately sixteen.

Q. What were the five or six principal states in which the volume of these sales were made?

A. Illinois, Michigan, Pennsylvania, West Virginia and Wisconsin.

[fol. 1649] Q. Missouri?

A. Missouri.

Q. Some of those states required deposits and others did not?

A. That is correct.

Q. Which of those that you mentioned required deposits?

A. Of course, Illinois required deposits; Michigan did not. Pennsylvania required a minimum deposit of a hundred thousand dollars.

Q. But not applicable to Series B?

A. Not applicable to Series B. West Virginia and Wisconsin required deposits.

Q. Missouri?

A. Missouri required deposits.

Q. Approximately what percentage of the total Fidelity assets today are Series B assets?

A. I would say approximately thirty-five per cent.

Q. Was the Series B contract available in more than one form or more than one additional privilege to the holder?

A. No, sir, there was but one Series B contract, but it [fol. 1650] could be issued with or without insurance, according to the option of the contract holder himself, and of course it so stated on the front of the contract, that it would be issued under Section Six, which is with insurance, or Section Seven which is without insurance.

Q. Was the Series B contract the only Fidelity contract that did have the insurance feature available?

A. Yes.

Q. Approximately what percentage of the contracts that were originally issued carried the insurance feature of Series B?

A. Approximately seventy-five per cent, took the insurance feature. Of course, on the books of the association it would probably average at that time about sixty-seven per cent, the total number that carried the insurance and the amount that let it lapse. There was about sixty-seven per cent with insurance and thirty-three per cent without insurance

Q. As of what date?

A. Well, that is of April 10th.

Q. What year?

[fol. 1651] A. 1941.

Q. Can you explain for the information of the Court just what this insurance feature is that is presently outstanding with respect to Series B?

A. Of course, it is—it is a group life insurance, and in case a contract holder should die that any given payment we would receive from the insurance company enough money to pay the contract in full, or to complete the payments on the contract.

The Court: Would you get that all at once, or would the insurance company simply pay the payments as they came due?

A. No, you would get it all at once, in which case your contract would be paid in full.

Q. Would you get the commuted value or get the actual total cash that would be paid over a series of years?

A. No, you would get the commuted value or the net value that was necessary to pay that.

Mr. Palmer: Could we have an example of that in figures, so we could understand what that commuted or net value was?

[fol. 1652] A. It is the present value of the contract. In other words, enough money so that at the maturity of the contract there would be enough there, improved at the same rate of interest, to pay the maturity value of the contract.

Mr. Jaegerman:

Q. Would the beneficiary be entitled to receive that amount immediately, or what was the practice of the company with respect to that?

A. Well, there is a cash surrender value placed upon the contract—an increased cash surrender value. Of course, that is according to actuarial tables and figures, the amount of the cash surrender. The payment practically covers the amount of that cash surrender. It has an increased cash surrender value every month.

Q. Then the beneficiary could hold the contract and turn it in to Fidelity at the maturity date and get the matured amount?

A. That is correct.

Q. And turn it in at any time prior to that date and receive a commuted cash value?

A. That is correct.

Q. What was the unit face amount of this Series B?

[fol. 1653] A. $1,250.00.

Q. What were the payments to be made?

A. $7.50 a month for a period of one hundred and twenty months.

Q. What does that total?

A. $945.00.

Q. Out of that $945.00 was Fidelity Investment Association entitled to make any deductions?

A. Yes, they were.

Q. For what purpose?

A. For loading and sales expenses and advertising.

Q. What was the permissible loading deduction on a unit contract?

A. The permissible loading deduction——

Q. To the agency.

A. To the agency division was $46.60, which was paid over a period of the first eight months.

Q. So out of the first eight payments of $7.50 the association would deduct or take $46.60 as its agency fee?

A. That is correct.

Q. What would be done with that money?

[fol. 1654] A. Part of it would be paid as commission to the salesman and the balance would go to the agency division administrative expenses.

Q. Accountingwise, would that $46.60 go into what you describe as the general fund or stockholders' fund profit and loss account?

A. I would say it would, yes.

Q. What was the next fee, and when was it deducted?

A. The association received an underwriting out of every payment except from the one hundred and eighth to the one hundred and twentieth month, a total of $36.13. It also received advertising fees payable out of the ninth payment of $1.97, making a total on a without-insurance contract of $84.70. On a with-insurance contract we deducted fifty cents a month for the first sixty months and twenty-five cents a month for the next sixty months, making a total of forty-five dollars. On a with-insurance contract that was used as insurance premiums for insurance—to carry the insurance. On a without-insurance contract it went into a special reserve fund as an additional credit reserve returnable to the contract holder.

[fol. 1655] The Court: Did the company get any of that?

A. It did, Your Honor, on insurance protected contracts it received the $45.00 if all the payments were made, making the total for loading on an insurance protected contract of $129.70.

Q. Did it get any of it on contracts where the owner died before maturity?

A. Well, it only got up until the time of death.

Q. I mean by asking you whether the company got it or not, I assume that this insurance was secured through some insurance company?

A. That is correct.

Q. Did you pass on that fifty cents or twenty-five cents to the insurance company, or did you keep part of it?

A. What we would do is figure the amount of insurance premiums that are due to the insurance company. Then the insurance premiums of fifty cents a month on all contracts are put into one account on the ledger, and from them the insurance premiums are paid for all of the contracts out of that one account in the ledger.

Q. You still don't get to my point. The insurance premi-
[fol. 1656] ums are paid to the insurance company, did they equal or exceed or were they less than the amount paid by the contract holders?

A. They were a little less, because there was some arrangement whereby the insurance company would reduce——

Mr. Jaegerman: A little louder.

A. There was some arrangement whereby the insurance company would either reduce the premiums or give us a refund of some of the premium back if our mortality rate was low. It all depended on whether our mortality rate would be low so we could get back a refund of some of those premiums, otherwise we would be paying out more than we received.

The Court:

Q. Do you know about how much profit went to the company out of those insurance premiums paid?

A. No, sir, I don't, Your Honor, offhand.

The Court: All right; go ahead.

Mr. Jaegerman:

Q. You do know, do you not, that those amounts were substantial in the last several years?

[fol. 1657] A. I wouldn't say they were too substantial, but they were—I don't like to venture a guess——

Q. They were an income item to the company?

A. Yes, they were.

Q. Was this contract sold with a cash surrender value feature?

A. Yes, it was.

Q. When did that become operative?

A. At the end of the twelfth payment.

Q. At the end of the twelfth payment how much would the holder have paid to Fidelity?

A. Ninety dollars.

Q. How much would the holder be entitled to as cash surrender value?

A. $25.00 on a with-insurance contract—on a without-insurance contract he would be entitled to $31.13.

Q. On a Series B contract without insurance, to what point would the holder have to carry that contract by monthly payments before the holder could withdraw from Fidelity as a cash surrender as much as he had paid Fidelity?

A. Did you say on a without or with?

[fol. 1658] Q. On a Series B contract without insurance.

A. Without insurance, he would carry it to the eighty-

ninth month. At the eighty-ninth month he would have paid in $667.50 and he would receive $667.00.

Q. What are the appropriate months for Series B contracts with the insurance feature?

A. With the insurance feature it would be the one hundred and ninth month. At that time he would have paid $817.50 and he would have received $817.50 as a cash surrender.

Q. Mr. Schellhase, you testified that this series was first offered on June 15, 1934.

A. That is correct.

Q. What year was the greatest volume of Series B contracts sold?

A. 1938.

Q. What is your estimate as to the average age of the Series B contracts presently in existence?

A. I would say between forty and fifty months.

Q. Would that mean that if the average Series B contract holder were even to get his full cash surrender value he would get back less than he had paid in to Fidelity?

[fols. 1659-1670] A. Oh, yes, he would get back less.

Q. Substantially less?

A. Yes, I would say.

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[fol. 1671] Austin L. King, called as a witness by the state court receivers, having been duly sworn, testified as follows:

Direct examination.

By Mr. Palmer:

Q. State your name, please.

A. A. L. King.

Q. Where do you live?

A. Wheeling, West Virginia.

Q. Were you formerly connected with Fidelity Assurance Association?

A. Yes, sir.

Q. How many years were you connected with them?

A. Directly and indirectly approximately twenty-five and a half.

Q. What various positions did you hold with the company?

A. Director, Assistant Treasurer, Vice President, Comp-
[fol. 1672] troller and Secretary.

Q. During what period of time did you serve as a director of the company?

A. I can't answer that definitely. I think approximately twelve to fifteen years, but not consecutively.

Q. Not consecutively. Were you a director during most of the time from 1922 to 1941?

The Witness: State the question.

(The question was read.)

A. Yes, sir.

Mr. Palmer:

Q. Mr. King, as such director, were you familiar with the legal services rendered to the company by the various attorneys who rendered legal services to the company and were paid therefor?

A. Yes, sir.

Q. Were you familiar as a director, with the amounts paid to those attorneys—not asking you to recall any given amount or definite amount?

A. Generally, yes.

Q. Will you tell the Court whether or not the board of directors, as such, approved of all of the fees paid to the various attorneys whom the company employed?

[fol. 1673] Mr. Ray: I think the minutes of the board would be the best evidence of that.

The Court: Well, let him answer if he knows. Go ahead.

A. All attorneys' fees were paid either before approval or after approval, but if paid before approval, were approved by the board.

Mr. Palmer:

Q. Were they first submitted to the general counsel of the company for investigation and report on them?

A. Many of them were, not all.

Q. The ones which were larger were submitted and the smaller ones perhaps not? Is that correct?

A. Many of them we submitted to what we know as our general attorney, the smaller items, for his approval.

Q. Mr. King, were you familiar with the work done for Fidelity by Mr. A. B. Koontz and members of his firm?

A. Yes, sir.

Q. And were you familiar with the amounts paid therefor in general?

[fol. 1674] A. Generally, yes, sir.

Q. Can you state, in your opinion, as to whether or not proper services were rendered for the amounts charged for the fees?

Mr. Ray: I object to that, Your Honor.

A. I think so.

Mr. Ray: I think that is objectionable. He is not——

The Court: Well, it is all right if he has any basis for his opinion in knowledge of the services and their value.

Mr. Palmer:

Q. Were you closely associated with Mr. A. B. Koontz in the work of Fidelity?

A. Well, for a number of years he was a director and represented the association as attorney through his firm, and naturally I was familiar with his work and——

Q. Were you familiar with the services that were rendered to the company by him and his firm—legal services?

A. Yes, sir.

Q. And it was of those and of that knowledge that you were speaking when you gave your answer? Is that correct?

[fols. 1675-1678] A. That is right.

* * * * * * *

[fol. 1679] Mr. Huwe: Your Honor, I think that that was [fol. 1680] a de facto directors' meeting, and therefore seven de facto directors, the necessary quorum, were present, Mr. Fleming being a de facto member, and those other members who did not qualify, we would say, if it is true, under the Investment Company Act, they were also de facto members, which makes their action perfectly valid.

The Court: That is a question for argument, and we are now developng the facts, and I don't think there is any contention on the part of anybody that there were more than six directors of the company at the beginning of that meeting.

Mr. Palmer: That is correct, Your Honor, and I was merely directing that to the witness's attention so we could get past the preliminaries and get into the points I wanted to examine him about.

Mr. Reinhardt: If Your Honor please, the Court's statement about that is not in accordance with my recollection, and I want to be set straight.

The Court: Maybe the Court needs to be set straight.

Mr. Reinhardt: It is my recollection that the testimony showed that there were six people present in Pittsburgh at some meeting on June 3rd, and that they purported to elect [fol. 1681] a seventh person as a director, and that then a directors' meeting was called. Is that in accordance with the fact?

Mr. Palmer: I can only ask one question at a time. I was going to develop that by Mr. King, and I thought there was no controversy about it, as the Court has said. I thought there would be no controversy about my preliminary question to refresh the witness as to what I was talking about.

The Court: That is my understanding.

Mr. Reinhardt: And as I recall, it was after Fleming's purported election as a director that what was called a directors' meeting was called.

The Court: I am not so sure of that, but anyway I am going to let Mr. Palmer go ahead with his question, even though it is technically objectionable.

Mr. Palmer: Read the question.

(The question was read.)

A. There were not seven present when the meeting was called to order as a directors' meeting.

Q. Mr. King, is it a fact that the six directors who were present at this meeting when it was called to order were [fol. 1682] John Marshall, Sr., John Marshall, Jr., A. L. King, F. H. Pulfer, H. E. Reed and A. G. Messick?

A. That is correct.

Q. Was there also present Mr. James R. Fleming, of Fort Wayne, Indiana?

A. Yes, sir.

Q. At that time, when the meeting was called to order, it is true, is it not, that he was not a director of the company?

A. That is right.

Q. That is the same Mr. Fleming who has been present here as counsel for the debtor? Is that correct?

A. Yes, sir.

Q. Mr. King, is this correct, that James R. Fleming suggested to the secretary of the corporation, F. J. McNulty, who was present at the meeting, that he become and be elected a member of that board of directors, that Mr. McNulty declined so to serve?

A. That is correct.

Q. And is this further true, that thereupon the said James R. Fleming stated, in effect, that he deemed it preferable for him, James R. Fleming, in the light of future matters, [fols. 1683-1684] not to become a member of said board, or serve thereon, but that as an emergency confronted them, and to make a quorum, he would consent to become a member of the board of directors at the meeting thereof held at Pittsburgh on June 3, 1941, and would resign at the close of that meeting?

A. In substance, that is correct.

Q. And that thereupon the said James R. Fleming was elected by the six directors in attendance at said meeting to be a member of the board of directors?

A. That is right.

. . . . . .

[fol. 1685] Q. Mr. King, will you give the Court your reason why you did not vote at the meeting in Pittsburgh to have the debtor file a petition in the United States District Court? Will you speak as loudly as you can, too, Mr. King, so we can all hear it?

A. Well, in discussing the matter briefly, which was very briefly, before this resolution was presented, I took the position that the receivers had not had time to submit a plan as had been anticipated or expected. In other words, when [fol. 1686] we did not fight the receivership case, it was understood very definitely that we would make answer to the court with a plan in due time, as quickly as possible. That had not been done. While I knew nothing definitely about what was being done by the receivers as to the plan or general work they were doing, I did know something about it through my contact with former employees and junior officers that were still in the organization—I knew they were working diligently on some plan; and I felt that they should have an opportunity, at least, to present this

before further steps were taken, that it was only consistent, and I felt that way very strongly, about it. I did feel that eventually, as it was generally understood, the matter would perhaps have to, after certain work was done through this state, be presented to the Federal Court in order to do some things that couldn't be done in the Circuit Court, and that was my reason for not voting for the resolution.

The Court:

Q. In other words, as I understand, Mr. King, you felt that it was premature?

A. I did, yes, sir.

The Court: All right.

[fol. 1687] Mr. Palmer: You may inquire.

Cross-examination.

By Mr. Ray:

Q. I understand you to testify that Koontz and Koontz were employed as attorneys for the Fidelity Investment Association in the proceedings in the state court in which receivers were appointed?

A. That is correct.

Q. When was that action taken?

A. I do not recall the date.

Q. You were at the board meeting at which that action was authorized?

A. Yes, sir.

Q. And did the firm of Koontz and Koontz accept that employment?

A. That is my recollection.

Q. And then you were at that time a vice-president——

A. I was.

Q. (Continuing:) of the association?

A. I was.

Q. Then it was your understanding as a vice-president of this association that at the time this proceeding was [fol. 1688] instituted in the Kanawha Circuit Court in which Isaiah Smith and Ross Thomas were appointed receivers in that court, the firm of Koontz and Koontz was representing the Fidelity Assurance Association in that proceeding?

A. That is correct.

Q. I believe you stated that it was your opinion at the meeting in Pittsburgh that this proceeding—that this reorganization—would eventually have to be completed in the Federal Court?

A. Just what do you mean by reorganization?

Q. Well, what did you mean by it?

A. I don't believe I mentioned the name reorganization.

Q. What was the term that you used that would have to be completed in the Federal Court?

A. I don't recall the term that I used, but I don't believe I mentioned reorganization.

Q. You did say something would have to be completed in the Federal Court, in your opinion, didn't you?

A. Yes, sir.

Q. And did you not mean the reorganization of this association?

[fol. 1689] A. No, not especially. I felt that the various state departments that held these securities would not release them unless it did go though the Federal Court.

Q. Was it your opinion that it would be advisable that it should go through a Federal court?

A. Not at that time. After we had definitely—very definitely—considered the matter and felt that the other plan would not work out. I thought that it was entitled to a chance, or at least a plan prepared and presented to the court.

Q. Would it be possible in the state courts to have any plan of reorganization made effective which was not entirely voluntary?

A. I didn't get that question.

(The question was read.)

A. I don't know.

Mr. Gray: I object to that question. That is a question for the Court, and not for this witness.

The Court: The objection is sustained on the ground that that calls for a legal conclusion of the witness.

Mr. Ray:

Q. What was the plan which you were awaiting, Mr. [fol. 1690] King?

A. I had no plan. The receivers were to prepare a plan, as I understood it, very definitely to present to the court.

Q. Were the receivers ordered by the state court to prepare a plan?

A. I wouldn't say. My recollection is that that was in the order.

Q. Did you ever have any conversation with the receivers in which they stated that they were preparing a plan?

A. I also talked to the receivers at one time and their attitude was that they were going to get to work and prepare a plan just as rapidly as possible.

Q. But you were never advised of any plan prepared by them——

A. No, sir.

Q. (Continuing:) Or any plan which they had under way?

A. No, sir.

Q. I want to ask you if at the directors' meeting in Pittsburgh, when the vote was taken on this resolution to file [fol. 1691] the petition, under Chapter Ten, the members present were not polled individually and every member present voted in favor of the adoption of the resolution and the chairman announced that the resolution had been unanimously adopted.

A. There was no such announcement made at the meeting. Had there been I would have immediately verbally told them that I was refraining from voting, but as there was no such announcement made I did not think it was necessary.

Q. Will you state just exactly what Mr. Fleming said at this meeting after Mr. McNulty refused to be elected a director?

A. The passage that Mr. Palmer read is as near what he said as I can state it.

Q. Can you state it now, what Mr. Fleming said, from what you know yourself?

A. Well, he stated in effect that he would prefer not to serve as a director, but it seemed that we were there in session and that an emergency existed, and he interpreted the by-laws to mean that he could be elected as a director, and I agreed myself that he could be, and he announced [fol. 1692] at the time that he would immediately resign at the close of the meeting. Naturally, being elected a director and serving, he had a perfect right to resign at any time he saw fit. That was my reasoning on it.

Q. I think you are right; Mr. King, in respect to that, and you voted for it?

Mr. Palmer: I ask that the remark of counsel be stricken from the record.

The Court: Overruled.

Mr. Ray:

Q. You voted for Mr. Fleming as a director?

A. I did.

Q. And you thought it was a proper election under the by-laws of the association?

A. Yes, sir.

Q. Is it not a fact, Mr. King, that previously in the history of this company there have been vacancies on the board and six members of the board have met, have elected a member to the vacant position on the board of directors, and then held a directors' meeting?

A. Yes.

[fol. 1693] Mr. Palmer: Just a second, Mr. King. I object to that, Your Honor; it has nothing to do with the question of the legality of that meeting.

The Court: Overruled.

Mr. Palmer: Exception.

A. That is correct.

Mr. Ray:

Q. And I will ask you if there was not such a meeting held on December 23rd, 1940, at which the general attorney for the company, Mr. Foulk, was present, and at which Mr. Gribben was elected a director to make the seventh director?

A. Yes, sir.

Mr. Palmer: I object to all of this, Your Honor.

The Court: Overruled.

Mr. Ray:

Q. I believe you wrote the minutes of the meeting of June 3rd?

A. I did.

Q. The directors' meeting of June 3rd?

A. I did.

Q. And what took place there is fully set out in the minutes, so far as you have any knowledge thereof?

A. That is correct.

[fol. 1694] Q. What services did the firm of Koontz and Koontz render Fidelity Association during the period from December 31, 1940 until April 10, 1941?

Mr. Palmer: Just a second, please. Your Honor, I asked Mr. King certain questions in order to clear up any impressions that might be wrongly existing in the record. I have already made a motion—I don't know whether Mr. Ray received a copy of it, because he wasn't of counsel at the time the motion was mailed out—to strike the question of attorneys' fees from this record. However, as I stated to the Court before, if we go into them I am not going to pick on the firm of which I am a member and single that out; we are going into every attorney's fee—that the Court thinks proper, of course—and every other auditing and every other unusual expense. I don't think it has any bearing in this case other than to attempt to embarrass certain counsel.

The Court: It may have been somewhat immaterial at the time it was first brought up, but during the hearing from September 15th on you have examined the witnesses with reference to the suitability of the receiver, Mr. Ross [fol. 1695] Thomas, who is shown to be a member of the firm of Koontz and Koontz, or at least associated with them. Now, on the question of this suitability as a receiver and as to whether the pending receivership is a receivership that would result in the best interests of all parties concerned, the Court feels that the prior connection of the firm of Koontz and Koontz—not every attorney, but the firm of Koontz and Koontz—with Fidelity becomes a very material thing, and as to the services performed and as to the compensation received and as to any and all connections that that firm had with this company, particularly if such connection had anything to do with the present condition of the company—I don't say that there is any indication yet that it had—but I do say that those things ought to be fully developed for the information of the Court; so I will overrule your objection.

Mr. Palmer: May I have my exception, please?

Mr. Ray: Read him the question.

(The question was read.)

Mr. Ray: I would like to amend that, April 5th, 1941.

[fol. 1696] A. Well, I know generally that they were representing the Fidelity in connection with the qualification

—qualifying as an insurance company and with the state departments—State Auditor—but I do not know the details. I am not familiar with the details. That was handled entirely by the president and others in the official family there. I had no particular first hand knowledge as to just the details of what was being done, but I knew generally they were handling that.

Mr. Ray:

Q. Then, I take it, you don't know what lawyers of the firm worked on any business for the association, do you?

A. Well, previously Mr. Goldsmith——

Q. I am talking about this particular period.

A. I do not.

Q. You don't know what particular matters they worked on?

A. No, sir.

Q. You don't know how many hours they worked on those matters?

A. No, sir.

Q. You don't know what their success or failure was with [fols. 1697-1709] respect to any matters, do you?

A. No, sir.

Q. Do you know how much was paid to that firm during this period?

A. No, sir.

* * * * * * *

[fol. 1710] Mr. Huwe: So that the information you had upon which you based your feeling and opinion that the state court receivers of West Virginia should have more opportunity to formulate a plan, did not include informa-[fol. 1711] tion that over a million dollars' worth of securities were sold in Wisconsin at that time, did it?

A. I didn't have that information.

Q. Would you qualify your opinion about the feasibility of a plan formed by a state court receiver under those circumstances? Would that change your mind, if you knew that a million dollars' worth of securities in Wisconsin were sold at that time?

A. I will have to think about that.

Q. How much time do you want?

A. I was not closely associated with the home office up there after the receivers were appointed. In other words,

I was out of the business. The information I received from time to time through contacting and talking with Mr. Foulk, who was connected with the receivers, and the association, was that the state departments, these ancillary receivers they are called, I believe, were co-operating.

Q. That was your information?

A. That was the information I got, and I based my opinion at that time on the information I had.

Q. Are you aware that Illinois likewise was preparing [fol. 1712] to liquidate the assets in Illinois?

A. No, sir.

Q. You didn't know that either?

A. No, sir.

Q. Now, there are three and a half million assets in Illinois, and I believe there are over two million in Wisconsin, a total of over five million. Now, if you had known on June 3rd that over five million dollars of your twenty-five million of assets, one-fifth, twenty per cent, was being or was about to be liquidated, would you have changed your opinion about giving the state court receivers more time to formulate a plan?

A. Possibly I would.

Q. Are you of the opinion that this company ought to be reorganized in a state or a federal court proceeding?

A. What do you mean by reorganization?

Q. Well, obtaining new capital, probably modifying in some degree the rights of contract holders, as would be done in a state court receivership or a federal court receivership.

A. I am in favor of anything that will protect the con- [fol. 1713] tract holders. I don't believe, regardless of the capital that is put into the association in the reorganization plan, and whether by the contract owners or outside people, it could be successful again in operating as Fidelity Assurance Association.

Mr. Palmer: Objection. That is not the way to present a plan for reorganization.

A. I further believe, if I may state, that if any plan could be developed whereby the company as a whole could be taken over by some other organization and reorganized in that manner, that that would be the better thing to do.

Mr. Huwe: Q. So that you do have an opinion that the company should be reorganized for the benefit of the contract holders?

A. If the reorganizaton plan is a better plan than liquidation.

Q. Do you think it would be better for the contract holders to have the company reorganized than liquidated?

A. It would depend on the type of reorganization.

Q. In other words, your answer would be contingent upon the plan that is formulated?

[fol. 1714] (Witness nods.)

Mr. Huwe: That is all.

Redirect examination.

By Mr. Palmer:

Q. Mr. King, is it not a fact that in Detroit in December of 1938, the Securities and Exchange Commission filed a suit against Fidelity and all of its officers to enjoin them from further proceeding with the business of selling, in substance? The suit was only against the company, not against the officers.

A. That is correct.

Q. Was it necessary that you employ attorneys to defend that proceeding?

A. That is correct.

Q. To your knowledge was there considerable legal work done in that proceeding by your company attorneys including Koontz and Koontz?

A. My general knowledge was that there was a great deal of legal work.

Q. Shortly thereafter was there a receivership suit brought in the northern district of West Virginia in United States court?

[fol. 1715] A. That is correct.

Q. Was there a lengthy hearing before the judge of that court and before a master appointed by that judge?

A. That is correct.

Q. Were not only Koontz and Koontz engaged in that, but your general counsel, Mr. Tom Foulk, and special counsel, Mr. Austin Wood, engaged in behalf of the company?

A. That is correct.

Q. And after that lengthy proceeding in 1939, was that not followed by an appeal to the Circuit Court of Appeals?

A. That is correct.

Q. And as to the success of those things, didn't your company remain out of receivership at that time?

A. That is correct.

Q. And your attorneys accomplished that to your knowledge?

A. That is correct.

Q. They won in both the lower court and the Circuit Court of Appeals on the receivership suit?

[fol. 1716] A. That is correct.

Q. And did you know that there was an enormous amount of work done by the attorneys in those two suits?

A. That is correct.

Q. Isn't it a fact that from the firm of Koontz and Koontz Mr. Arthur Koontz and Mr. Walter Goldsmith and Mr. Harry Lambert were all three in Wheeling?

A. The last?

Q. Harry Lambert.

A. I never met him, but I believe there was a gentleman there by that name.

Q. These three members of that firm were in Wheeling working on it?

A. That is correct.

Q. Do you know how many weeks or months they were in Wheeling during that one suit, approximately?

A. I think approximately three to four weeks.

Q. Do you know how long the proceedings went on in Federal Court in Detroit?

A. I do not.

Q. Were they some length of time?

A. Possibly a day or two.

[fol. 1717] Q. And were you able to go on with your company after those proceedings were finished?

A. Yes, sir.

Q. Did you also know that there was a report being prepared so that you could comply with certain laws passed by Congress for making certain reports to the Securities and Exchange Commission in 1939 and 1940?

A. Registration reports?

Q. Yes.

A. Yes.

Q. Did you know that there was an enormous amount of work in that to be done?

A. Yes, sir.

Q. And did you know that Koontz and Koontz, in connection with your general counsel, Mr. Tom Foulk, were doing that?

A. Yes, sir.

Q. And did you know that Mr. Ross Thomas was playing a large part in preparing that registration report?

A. Yes.

Q. State whether or not there was a great deal of work in that.

[fol. 1718] A. Well, the report would speak for itself. It was about two inches thick, including statements and kindred matter.

Q. And all of that had to be prepared from the company records, and translated into the proper form? Is that correct?

A. That is my understanding.

Q. Who worked actively, of your official group of Fidelity, with Koontz and Koontz in these matters—what officers of the company?

A. Mr. Fred Risley, I think Mr. McNulty to some extent, Colonel Thompson was president at that time, and a member of the committee, and various junior officers and clerks.

Q. I believe you stated that Koontz and Koontz were receiving a retaining fee of $200 a month?

A. That is correct.

Q. And then they were paid for other items of work which they did? Is that correct?

A. That is correct.

Mr. Palmer: Now, if Your Honor please, I ask that the attorney for the debtor state in open court into the record [fol. 1719] whether or not they intend to produce any evidence either that the work was not done or that the fees charged therefor were unreasonable by Koontz and Koontz, and if they do not care to state that into the record, that this evidence be stricken out.

Mr. Ray: May it please Your Honor, I didn't put this witness on the stand to show that Koontz and Koontz had done legal services for which they had been paid a fair and reasonable compensation. He was so produced by Mr. Palmer. He put him on the stand and he had him testify that the firm had done these services and that the fees were

reasonable, and all I did was to attempt, perhaps ineffectually, to show on cross-examination that the witness did not know what he was talking about, and that he wasn't competent to express an opinion such as he had done.

Mr. Palmer: Will the debtor either state one way or the other that the fees were unreasonable or services were not performed or that they are not interested in that feature, so we will know how far we shall go?

Mr. Ray: I am sure that I am not called upon to express any opinion about the firm's legal services, because I don't [fol. 1720] know what it did.

Mr. Palmer: Is the debtor prepared to produce any evidence on it one way or the other?

Mr. Ray: I see no reason why we should at this state of the proceedings.

Mr. Palmer: I don't either, so I move to strike all testimony out until the report under 167 comes in.

The Court: The testimony will not be stricken out, but will be retained in the record, but only for the purpose of its bearing upon the suitability of Mr. Ross Thomas as one of the state court receivers under the inquiry in Subsection 4 of Section 146, Chapter 10, as to whether or not there is a pending proceeding in which the rights of the parties will be better subserved.

Now, is there anything else that can be done this afternoon? We had better get through with Mr. King.

Mr. Palmer: I have finished with Mr. King. If any others have questions of him, I think he should be questioned now and be free to leave.

[fol. 1721] Cross-examination.

By Mr. Reinhardt:

Q. Mr. King, you are familiar generally with the problems that confronted Fidelity at the end of 1940 and the beginning of 1941, and the consideration that was given to those problems; are you not?

A. Yes.

Q. Will you outline for us very briefly the consideration that was given to the problem of reorganizing Fidelity, if consideration was given to that problem, during the beginning of 1941?

A. The beginning of 1941?

Q. Well, start at any convenient period that will give us a full picture of the consideration that occurred during 1941. If you have to go back a little, go ahead.

A. Well, with the amended S. E. C. Statute—whatever you call it—coming into force on January 1st, we knew previous to that time that we could not continue to sell our contracts as Fidelity Assurance-Investment Association after that date. We felt, in view of the fact that we had been selling an insured contract for a period of four or five years which appealed to the public, that we could con-[fol. 1722] vert our association into an insurance company and broaden our field of activity to include other types of insurance and make a specialty of the sale of an insured contract that would pass the requirements of the State Insurance Commissioner.

Q. You were going to expand your field?

A. That is right; that is right. And with that in view, we decided to change our name, change our type of business from an investment contract or investment certificate, as you people class it, to an insurance business; and that was the procedure that we were trying to work out. We did change our name. We made application for license as an insurance company, but we were never able to actually start selling and operating. We had our material, our contracts, our policies and everything, our sales material ready in great part, not complete, but had we been able to operate it would have only required a week or two to have completed our material and placed it in the hands of our agents for sale. Licenses were also issued to our salesmen that we made application to license, but we were instructed, "Don't deliver the licenses until" we had been advised or informed by the insurance commissioner that it was all right to go ahead.

[fol. 1723] Q. And you never were so advised by the Insurance Commissioner?

A. No.

Q. What held up your plan? What interfered with your plan?

A. I don't believe I could answer that question. The Insurance Commissioner made some demands that required some things to be done that seemingly couldn't be done or were not done, and I think that was the reason.

Q. And early in April there was a receivership proceeding?

A. That is right.

Q. Did you know in advance about this receivership proceeding?

A. A day or two in advance.

Q. On April 4th some action was taken by Mr. Sims?

A. I believe that is correct, approximately a week before the receivers were appointed.

Q. And you were apprised of that?

A. We were instructed, is my recollection, to discontinue paying cash surrenders or making loans on contracts and to impound the payments that came in. I think that was [fol. 1724] April 4th.

Q. And was it around that time that you hired Koontz and Koontz for the purpose of this receivership proceeding?

A. I believe so. That is my recollection.

Q. Do you know what pleadings or what papers were filed by the company in the receivership proceeding?

A. No, I don't.

Mr. Palmer: I think the records of the Circuit Court of Kanawha County would speak as to that, your Honor.

The Court: Well, he doesn't know anyhow.

Mr. Reinhardt: Do you intend to produce those records, Mr. Palmer?

Mr. Palmer: I can't answer that offhand, Mr. Reinhardt, but I can answer in the morning. If there is anything you want, of course I will be glad to produce copies of it for you.

Mr. Reinhardt: Well, offhand, I should say that at a minimum this record should contain the petition and answer. As I recall, the petition is in.

Mr. Palmer: There was no answer. No answer was filed by anyone, not even an appearance was filed.

(The colloquy contained in the foregoing fourteen lines was read at Mr. Reinhar-t's request.)

[fol. 1725] Mr. Palmer: There was an appearance filed, but no consent to nor denial of the receivership was filed, and I think the receivers' reports from time to time were filed in the proceedings.

Mr. Reinhardt: You would know whether that matter is going to help the Court. I have no familiarity with that. If it would help the Court I think it ought to be produced.

Mr. Ross B. Thomas: I am familiar with the reports, but they cover special matters, such as borrowing money to liquidate a loan at Continental Trust Company.

Mr. Reinhardt: I will await your answer in the morning.

Mr. Palmer: Suppose Mr. Thomas and I confer as to whether those reports would give any information to this Court other than the work done by the receivers. I don't think the Court is interested in whether they have done a great or small amount of work, but if there is anything in the papers which will aid the Court in this determination, we will be glad to file them.

Mr. Ray: You said an appearance was made. Was it by the Association?

Mr. Palmer: Yes, by the Association.

[fol. 1726] Mr. Ray: What attorney made the appearance?

Mr. Palmer: I presume Koontz and Koontz.

Mr. Ray: I would like to know.

Mr. Thomas: You want to know the name of the individual attorney?

Mr. Ray: Yes, sir.

Mr. Thomas: Mr. Goldsmith.

Mr. Ray: Who presented the bill to the Court?

Mr. Palmer: If you want to examine witnesses, Mr. Ray——

Mr. Ray: You started out here to make certain statements about that proceeding. I am just trying to get it complete.

Mr. Palmer: I was only trying to answer Mr. Reinhardt's question that we give him any information we could in the way of the papers that were in the Circuit Court.

The Court: Well, it seems to me that attorneys can give information that will shorten the taking of testimony. If they get technical, and require witnesses to be put on the stand, I think they ought to be put on. This Court doesn't want to be trifled with by technicalities in order to satisfy counsel's pride or whatnot. We want to get at the truth.

Mr. Palmer: That is correct, your Honor; that is what [fol. 1727] we all want.

Mr. Reinhardt: I wonder if we can't handle this whole thing by Mr. Palmer's statement in the morning.

The Court: All right; let's do that.

Mr. Reinhardt:

Q. Mr. King, what discussion was there of a program for the Company in connection with this receivership proceeding?

A. A program for what?

Q. For anything. Where did you think the receivership proceeding was going to be? What did you think would be accomplished or what did you hope would be accomplished?

A. Well, my impression was that in order to have a starting point the Court had to step in and stop the payment of surrenders, maturities and loans. Then we would have a starting point to prepare a plan to submit to the contract owners or the stockholders or both. That was the impression I got. I think it is correct.

Q. Was there any discussion of this matter among the Directors?

A. Yes.

Q. Will you tell us what the nature of those discussions was?

[fol. 1728] A. It was right along that line, that we had to have a starting point to prepare a program to submit to the contract owners, and it was just a general discussion on that subject.

Q. On April 4th there was this so-called freezing order which accompanied what you have referred to as the starting point, and that followed on April 11th by the appointment of receivers. Was there any discussion among the Directors after the appointment of receivers as to the course of the receivership?

A. As to the cost?

Q. The course—the future of the company.

A. Well, the discussion was that we could work out a plan—the receivers could, through the cooperation of the officers and the directors—that would be satisfactory to the contract owners.

Q. You said that it was understood that the receivership would ultimately be shifted into the Federal Court.

A. That was never brought up for discussion at a directors' meeting to my knowledge or recollection, but in talking among ourselves, I got the impression, through counsel, that that would eventually possibly have to be done, for it was felt by some, and I felt so myself, that some State [fol. 1729] departments would not go along on any plan of that nature, that they would have to be pulled, and the only way it could be pulled would be perhaps through the Federal Court.

The Court:

Q. Mr. King, did you say you got that impression through counsel?

A. Well, in talking with Mr. Foulk, our general attorney up there, just casually—not formally, but casually.

Q. Did you ever talk to Mr. Koontz about it?

A. I believe I did. I think I——

Q. What was his idea?

A. That was his impression, that eventually we would have to perhaps go to the Federal Court with our plan worked out as far as we could get in the other courts or with the State departments—we would handle it that way.

Mr. Reinhardt:

Q. You testified that a large volume was prepared by Koontz and Koontz for filing with the Securities and Exchange Commission. Was that ever filed with the Commission, or do you know?

A. I don't think it was filed formally. I think it was given them informally to look over, is my recollection.

Q. Fidelity never sold any new contract after December [fols. 1730-1752] 31st 1940, did they?

A. Not to my knowledge.

Q. Do you know for what purpose that statement was prepared? Was it to comply with the Investment Company Act of 1940 or with some other statute?

A. It was prepared to comply with the Investment Act.

Q. Do you know that of your own knowledge, or is that just an impression that you got?

A. Well, I don't think there is any question that the statement, when we authorized the preparation of that statement, we felt that we would get in additional new capital that would enable us to qualify under the Investment Act. In the meantime, this amendment to the Investment Act, my recollection, was passed, which had something to do with it.

Q. Well, perhaps you and I were not using the same language. What you referred to as an amendment to the Investment Act is what I have referred to as the Investment Company Act of 1940.

A. Oh! I meant the original Act, and then the——

Q. That was another statute.

A. Oh, was it?

* * * * * * *

[fol. 1753] D. A. BURT, called as a witness by the debtor, having been duly sworn, testified as follows:

Direct examination.

By Mr. Ray:

Q. Have you been sworn?
A. Yes, sir.
Q. What is your name?
A. D. A. Burt.
Q. What is your age?
A. Sixty-four.
Q. Where do you reside?
A. Wheeling.
[fol. 1754] Q. What is your occupation?
A. I am a businessman.
Q. How long have you lived at Wheeling, West Virginia?
A. All my life except a few years when I lived in Steubenville, a nearby town.
Q. How long have you been engaged in business in West Virginia and other places?
A. Forty-seven or eight years.
Q. Are you now a director of any business corporation?
A. Yes, sir.
Q. Will you state what they are?
A. The Wheeling Steel Corporation, the Continental Roll and Steel Foundry Company, the Woodward Iron Company, of Birmingham, Alabama, the Fidelity Investment Association, the Jefferson Coal Company, one or two minor ones—Chesapeake and Potomac Telephone Company.
Q. Are you a director of the Fidelity Assurance Association?
A. Yes, sir.
Q. How long have you been associated with Fidelity Assurance Association and its predecessor, the Fidelity [fol. 1755] Investment Association?
A. I think since about 1920.
Q. Have you held any offices in that association?
A. I was a director and member of some of its committees, I think for a little while vice-president, and for seven years was president in the earlier history of the company.
Q. Do you recall the years in which you were president?
A. From 1923, I think, until 1930.

Q. From your association with the company, are you advised of the nature of its business and of its present condition?

A. I think so.

Q. Will you please state whether or not, in your opinion, based on your experience as a business man and on your knowledge of Fidelity Assurance Association, the association should be reorganized?

A. Yes——

Mr. Farmer: Just a minute, if the Court please. We object to that question whether or not it should be reorganized. The question is as to whether or not there is [fol. 1756] a reasonable chance of a fair and equitable reorganization.

The Court: This question could very readily lead up to that. I will overrule your objection.

A. Yes. I would like to qualify that, however, Mr. Ray.

Mr. Ray: Well, go ahead, Mr. Burt.

A. If all the parties in interest will stop quarrelling, so to speak, and join hands in an honest effort to protect the contract holders, I think the company can be reorganized.

Q. In your opinion, can this Fidelity Assurance Association be reorganized?

A. Yes.

Q. Do you care to state your reasons for your opinion that it can be reorganized?

A. The company, like all the other companies with which I am identified, lost considerable money at the time of the depression of '29 and '30. It had a very large portfolio, and naturally there was some depreciation in that portfolio. All of the other companies with which I have been identified are making money. One or two of them [fol. 1757] have gone through reorganizations, one of them under this same 77B and another one through voluntary reorganization. They have all gotten on their feet and are in a sound position today and all are making money except Fidelity. I think if the same judgment is used in reorganization Fidelity and, as I said, if all the interested parties will get together, it can undoubtedly be reorganized and made a going concern again, and the in-

terest of the contract holders will certainly be more protected and better protected in a reorganized company than in a liquidation.

The Court: Now, Mr. Burt, I would like for you to go a little further and give the Court a sort of outline of your ideas as to in what way the company should be reorganized. How would you go about it?

A. Well, if Your Honor please, I think, on account of the widespread business the company did in various parts of the United States, under various laws, that it is absolutely essential that one central court take custody, and I think that should be a federal court.

Mr. Farmer: We object to that answer and move that it be stricken. That is not responsive to the Court's ques- [fol. 1758] tion, the answer that one central court take custody. That has no relevancy on the question of how it can be reorganized.

The Court: I will overrule the objection. Go ahead, Mr. Burt.

A. It seems to me essential that a plan be obtained that will meet the approval of the SEC and of the Auditor of the State of West Virginia. The interests of the stockholders are secondary. I am a very large stockholder—that is, my family is probably the second largest stockholder in the company. I am not interested in that at all, and I am very definitely interested in seeing that these contract holders get all their money with the least possible overhead expense, and I think that can be done in a federal court. Does that answer you?

The Court: I would like for you to go a little further and say what type of organization you have in mind, when you say that you believe it can be done.

A. The first thing, of course, is to get a plan of such character that new capital can be obtained. If that plan is actuarily sound, and, as I said, meets the approval of [fol. 1759] the Securities and Exchange Commission and of the Auditor of this State, I think the capital can be found. If the general fund of the company is improved by the addition of a large amount of capital—and I admit that is a large amount—the contract holders are infinitely better off than they would be in the event of liquidation.

Q. Well, it is your idea that it should be continued as a face amount certificate company solely or some other form or a combination of more than one form of business?

A. I don't know, Your Honor. It would seem to me a committee on reorganization would have to work that problem out with the supervisory authorities. I understand some of them object to that type of contract. If that is the case, the contract would have to be so modified as to meet their desires.

Q. In view of the somewhat stringent requirements now of the Investment Company Act, do you believe that the reorganized company could be made attractive enough from an earnings viewpoint that new capital would seek to go into it?

[fol. 1760] A. Yes, I think the problem of earnings depends, of course, on interest rates. Interest rates generally are very low. Savings rates are almost non-existent in the territories with which I am familiar. Obviously, Fidelity's reserves will have to be figured on a rate that takes into consideration prevailing interest rates. If such rate is arrived at, there is no reason why the company should not conduct a profitable business. There is certainly need for thrift in America, and all Fidelity has been doing has been selling a plan—a thrift plan or a savings plan—to a rather thriftless people. Now, that may take the form of an annuity and income contract, and assurance contract. It may have in it some form of insurance. It may be all insurance. But there is a field there for systematic saving, and a saving that has a definite objective. The little notice that came to my desk once a month was a reminder to me that it was time to put a little bit of money away. It was a reminder to me; it was a reminder to many of their contract holders, that they should continue their savings, and that was what Fidelity was selling, a plan. I think the field is broad enough so [fol. 1761] that the company, even on a very small margin of profit on an individual unit, could operate on a sound basis. Does that answer your question?

The Court: Yes, that answers that question. Let me ask you this. The company heretofore has been operating with a larger permitted margin of profit, as I understand it, and yet it has now become insolvent to the extent of some two and a half million or more. Can you explain why that

would be and yet reasonable that with your statement now that a new company could make money?

A. Well, part of the reason is that for the last several years the company has been under tremendous expense in connection with litigation. I don't know what its litigation has cost in total, but I am informed somewhere between six and eight hundred thousand dollars. That expense, it seems to me, if a sound plan was adopted, would be unnecessary to the new company. A part of this loss occurred in the depreciation of the very large securities account back in '29 and '30. I think the securities account at that time ran over thirty millions, and there was prob-
[fols. 1762-1769] ably five or six million depreciation. That is not any greater relatively than many of the insurance companies and many of the banks had in their portfolio. That amount would have been recouped ere this time with the normal business that Fidelity was doing and without this rather abnormal expense, had Fidelity continued business as it was doing.

Q. It is your testimony, then, that aside from the extraordinary legal expenses and other similar expenses of the last two or three years that Fidelity has been on the upgrade since the great depression of 1932?

A. Yes, sir.

. . . . . .

[fol. 1770] Q. Mr. Burt, under these present contracts a person had to pay into the company for between six and eight years before they could ever hope to even get the money back without interest which they had put into the company by virtue of these contracts. Isn't that true?

A. I don't know the period, Mr. Palmer, but practically all insurance has that same situation.

Q. But in an insurance policy, if you die during the period your estate receives the face value. In this you get nothing back——

A. I think you are mistaken.

Q. In this you don't get your money back even until you pay for six or eight years. Now, is that something that is generally desired by the public, in your opinion?

[fol. 1771] Mr. Huwe: Your Honor, I object to that question on the ground that he is projecting into the future the specific terms of a contract of a face amount certificate company. In the first place, the reorganized company may

not be a face amount certificate company. In the second place, the terminology of the contract may be entirely different from the terms which he has projected into his question; and therefore, I think that we are going too far afield and that is not a competent question.

The Court: Overruled. You may answer.

(The last two questions were read.)

A. The contracts are sold with that understanding. I don't know about the six or eight years. I am not in close touch with that. They are sold with that understanding and the contract holder enters into his contract to make his monthly payments; so that if he takes his contract with that understanding I don't think there is any injustice done to anyone.

. . . . . .

[fol. 1772] Q. Isn't it true that if the public were fully advised that they could invest in either a savings back or a government bond and get their entire money back at any time, plus some small amount of interest, that they would not thereafter want to invest in something that would take them six or eight years to get their money back, the amount they put in it, without interest?

Mr. Ray: If it please Your Honor, we object to that, because in cross examining Mr. Young yesterday the same question was asked, and Mr. Young clearly pointed out to Mr. Palmer that the cost of carrying this contract for the contract holder, the cost of making these investments [fol. 1773] for him, the cost of working out this plan, is what the contractor paid for. There is no use going into it again.

The Court: Overruled. Go ahead.

Mr. Palmer: If Your Honor please, I think the remarks of counsel to one witness what another witness has said in the form of an objection should be striken from the record, and so ask.

The Court: Well, it is already in. If there has been any harm it is already done, so overruled.

A. I don't know how familiar you are with the contract that was sold, but it assumed a definite time, it assumed that the contract holder would do certain things, make monthly payments and so on. It delegated the company

to purchase securities, and those securities, generally speaking, were bought with the idea of maturing the contract at its maturity date, and not with the idea, except some of them for valdity, that these folks would all come in within six months or a year and get their money. It was a systematic savings plan which contemplated returning to a man his money with a profit at the end of the period if he continued his plan. It had loan values which were specifi- [fol. 1774] cally on the contract, and it had cash surrender values; it had certain death benefits; and the company had to maintain an investment staff, investment committee, depositories, and go through all the details of the management of a very large trust estate; and for that the contract holder had to pay, and those who continued according to their contract to the end always made money. Those who, like in many other instances, changed their mind half-way through, or something of that sort, naturally didn't make as much.

Mr. Palmer:

Q. Mr. Burt, did you know that the experience of the company as developed by the Securities and Exchange Commission, showed that only five per cent plus of the contract holders ever carried their contracts through to maturity?

A. That doesn't alter my answer.

Q. It doesn't?

A. No. The company's organization was there ready to carry through.

Q. Mr. Burt, first as to cash surrenders, if a man invested from one to five years in Fidelity and put an equal amount in either defense bonds or a savings account, at [fol. 1775] the end of the five years with either the bank or the United States Government he could receive his money that he paid in in full, plus interest. Isn't that true—if he wanted to quit?

A. Yes.

Q. With Fidelity, if he wanted to quit at the end of the five years, he would not receive in return even the money which he paid in. Isn't that true?

A. I don't know about the time.

Q. All right, sir.

A. But there is a very great difference between the Fidelity contract and a savings bank deposit.

Q. All right, sir. I would be glad to have you develop it.

A. They are made very definitely for different purposes. If a man has a bank account he takes it out, like we all do. If he wants insurance he takes that out. If he wants a systematic savings plan, he takes a Fidelity contract.

Q. Isn't the essential difference that with the systematic plan he can save exactly the same way with the bank——

A. But will he?

[fol. 1776] Q. (continuing) That he could with Fidelity, with the exception that Fidelity sends him a notice each month to pay and the bank doesn't?

A. Well, I will cite my own case. I had a savings account and I had some Fidelity contracts. I put in the savings bank if and when it was convenient, and very often I bought something and didn't put the money in the bank. As a consequence, the savings account didn't grow very much. But every month I got a little reminder on my desk that it was time for me to pay $10.00 or $7.50 into this Fidelity contract. My savings account never grew very much, but my Fidelity contracts did grow.

Q. If, in the case I have given you, at the end of five years you would get the money back in full from a savings bank, with interest, and at the end of five years you wouldn't even have got your moey back from Fidelity, wouldn't it have been much cheaper to have your secretary lay a little notice on your desk each month and say, "Mr. Burt, deposit so much in the savings bank", rather than to pay Fidelity when they wouldn't even give you your money back?

[fol. 1777] A. As a matter of fact, our contract holders, very few had secretaries.

Q. For a very reasonable amount wouldn't your secretary or anyone else's be glad to mail them a notice to deposit in a savings bank?

The Court: I think that question has gone far enough. It is not so much a question of reminder as a question of compulsion on the part of the contract holder to pay or lose what he had paid, so there is another element besides reminder.

Mr. Palmer: All right, Your Honor.

Q. Now, Let's look at the loan value you are talking about. If a man pays into a savings bank a thousand dol-

lars and any time he wants to use his own money he can take that money out. Isn't that correct?

A. If the bank is solvent, yes.

Q. Yes, if the bank is solvent. If a man pays into Fidelity a thousand dollars he can take his own money out provided he pays Fidelity six per cent for doing it. Isn't that right?

A. The Fidelity tables are based on actuarial calculations by the best actuaries in the country, and are somewhat [fol. 1778] similar to insurance tables. I am not going to go into the details of the actuarial tables of Fidelity.

Q. My question is this, if a man had a thousand dollars that he deposited in a savings bank, and he wanted to use his own thousand dollars, which he was going to pay back in two or three years, he could do that without any charge of interest; but if, on the contrary, he had a thousand dollars in Fidelity and wanted to use his own thousand dollars and he was going to pay it back in three or four years, he would have to pay Fidelity six per cent for the use of his own thousand dollars, wouldn't he?

A. The difference is this. When a man put his money in a savings bank he made one type of contract. When he put it in Fidelity he made a different type of contract.

Q. I agree with you, but my question is that that is true that I asked you, is it not?

A. I don't know.

Q. You have spoken of the possibility of new capital being attracted to Fidelity. There is evidence here that [fol. 1779] there was a high turnover in salesmen, and an example is cited. In the year 1936 there were six hundred and thirty-four salesmen at the beginning of the year, there were eleven hundred and eighty-two new salesmen hired during the year, and one thousand and fifty left the employment of the company during that year—quoting from page 88. With such a high turnover of salesmen, does it not indicate that the article being sold was very difficult to sell?

A. In what year was that?

Mr. Ray: May it please Your Honor, that is certainly objectionable.

The Court: I will sustain the objection to that question. That question is entirely argumentative, and so are many of the others that have been asked this witness.

Mr. Palmer: I expect Your Honor is correct in that, and I will not insist on it further.

The Court: Those matters may be used in argument, but I don't think it is proper in your question.

Mr. Palmer: Your Honor is probably right.

Q. Mr. Burt, let me ask you this. If Fidelity had to [fol. 1780] spend large amounts to sell the contracts which it was selling, with the rate of improvement to reserve which it then offered, would it not have to spend a larger amount to sell another face amount annuity contract in which the reserve would be improved at a much lower rate, in your opinion?

A. No, I don't think that is necessarily true. Interest rates on everything are going down, as I said, and it is only natural that interest rates on the Fidelity contract, whatever type it becomes, will go down. The relative return is the thing that counts. If you get a half of one per cent from a savings bank and get one per cent from Fidelity, you are better off with Fidelity, if Fidelity is well managed.

Q. My point is this, Mr. Burt. I think your answer has given me partially the answer that I want, but you are not prepared to say, are you, that Fidelity should again engage in the selling of face amount certificates as a sole business?

A. I won't answer that. That is a matter for the committee and the SEC and the Auditor to work out.

Q. And I say, you are not prepared to say that, in your [fol. 1781] your opinion, it should engage in that business alone, are you?

A. Not without a great deal of study.

Q. Which you have not——

A. Which I have not made.

Q. Did you know, Mr. Burt, that Fidelity had formulated, during the latter part of 1940 and the early part of 1941, a number of various plans to submit to contract holders, so that it could go along as a going business?

A. I knew nothing of that. I was not on the reorganization committee.

Q. Did you know that Fidelity had worked on that idea?

A. I knew there was a committee appointed and they were supposed to be at work. They never reported to the board, and I didn't know what they had done.

Q. But you knew there was a committee supposed to be working on that idea?

A. No, I don't know what idea they were working on. They were working on a plan for reorganization.

Q. Yes. That was what I meant. And you don't know what work that committee did?

[fol. 1782] A. No.

Q. Now, Mr. Burt, would this be fair to state, that it is your opinion that there is in the investment field room for a company which will aid persons who will contract with that company in making periodic and systematic savings?

A. Yes.

Q. And it is your idea, is it not, that the value—one of the principal values of the company, of course excluding the fact of good management and safety in investment—is that it will give notice to each contract holder or person who contracts with the company periodically of the time to make their next payment. That is one of the principal features, is it not?

A. It is a systematic savings plan, and I think that monthly notice is of some value, yes.

Q. And the systematic savings, that is, savings at regular intervals, is an added value in that field. Isn't that your idea?

A. That is a part of the service that the company renders; not all; that is just a part.

[fol. 1783] Q. That is what I say. And it is your idea, is it not, that the systematic savings is the idea which Fidelity has as one of its main ideas which should be preserved through some form of rehabilitation satisfactory to the ones connected with it.

A. That was the idea of the founder of Fidelity, who was a banker and also an insurance man, that some form of systematic saving was desirable for the American people, if I may use that broad term; and I think the management, as long as I was active in it, followed that idea of Mr. Paull's.

Q. And that really the fact that the amount of interest that people get, or that they may have loan values and so forth, is secondary to that main idea of the savings plan, systematically carried out by the contract holder. Isn't that true, Mr. Burt?

A. I would put the systematic savings first; and the financial results, naturally, must be equitable, and the company's

earnings must be based upon a fair compensation for the services which it renders.

Q. That is why, when I was asking you about savings banks, the mere fact of saving, of having your money held, [fol. 1784] can be done in any one of a number of ways, but Fidelity is the only one, or the largest one which has carried through and carried out the plan of systematic savings by those that would contract with it. Isn't that correct?

A. I wouldn't say it was the largest one. It is one of them, and as I repeated two or three times, I think there is a field for that type of systematic savings in a country that is notably extravagent. It won't hurt them to save, and save systematically.

Q. And it is your present thought that this present company can be rehabilitated into some form of company satisfactory to the various state and federal officers so that that idea can be carried on and perpetuated. Isn't that true?

A. Well, I have already answered that, and I have qualified it. I think it can be done, and I think it should be done.

Mr. Palmer: That is all the cross-examination I have, Your Honor.

The Court: Make it as brief as possible, Mr. Farmer. We are lagging some.

[fol. 1785] Cross-examination.

By Mr. Farmer:

Q. Mr. Burt, you have expressed your opinion as to the desirability of some reorganization of this company. I take it that you would agree with me that just a general disposition of persons connected with the company and others who sympathize with it in its present distress would not warrant delaying the contract holders who at the present time have their money in the company from getting their money out, unless there is a good, fair chance at present of a reorganization that will be approved.

A. I think that would be a matter for the court who took custody to rule on.

Q. I guess you would agree with me also in this, Mr. Burt, that the question of whether or not a company can be organized with a reasonable chance of successful operation under the present laws, particularly the Federal Investment Company Act, as a new company, is rather far removed from the present problem that this Court is dealing

with, that is, this company that is now in financial difficulties?

[fol. 1786] A. I don't believe I know just what you are driving at.

Q. I say, the question of whether you can organize a new company that is likely to succeed—an entirely new company, with new capital, starting out fresh, is a distinct question from the question of whether this company can be reorganized.

A. Yes, I answered that I thought this company could be organized. Does that answer you?

Q. You answered, I believe, as I understood you, that you thought the present common stockholders ought to have some equities in the new company.

A. Merely future earnings, if there are any.

Q. Sir?

A. Merely future earnings, if there are any.

Q. What form would those equities take that you have in mind?

A. Might take the form of——

Q. I can't hear you, Mr. Burt.

A. I don't know whether the Investment Act would permit it or not, but I would think a no-par security of some sort.

[fol. 1787] Q. Voting rights?

A. Yes.

Q. Voting rights. Will you speak out just a little bit louder. It seems to me like I am a little hard of hearing. Have you gone into the situation and are you familiar with the situation of this company with respect to deposits of securities in the different states——

A. No.

Q. (Continuing:) Securing these contracts?

A. No.

Q. Sir?

A. No.

Q. Did you say that you became a director of the company in the spring of this year again?

A. Yes.

Q. And you had not been a director for about two years?

A. Prior to that.

Q. About two years previously you had been; and then became again this spring?

A. Yes.

[fol. 1788] Q. Are you aware of the fact that approximately ten million dollars of the assets of this company are at the present time being held by state officials in states other than the State of West Virginia under laws of those states requiring deposits for the protection of contract holders in those states?

A. I don't know anything about the amount. I know there are some deposits in other states.

Q. You didn't know that there was as much as ten million dollars held in other states than West Virginia?

A. I did not.

Q. Did you know that about ten million dollars of the assets and securities of this company were, at the time the petition was filed or the present time, in the hands of the Treasurer of the State of West Virginia for the protection of contract holders who put their money in this company?

A. I didn't know the amount. I knew there was a large amount down here. After all, you know, we have committees and officials and auditors, and we have lawyers, so that the technical details of the business as they affect those different groups are in their charge, and as a director [fol. 1789] I assumed that the deposits that were being made were in accordance with the laws of the various states and in the proper amounts, and I don't know whether that was five hundred thousand or three hundred thousand or seven hundred thousand in any one place, and I didn't think it was my duty, as a director, to inquire into that when we had specialists there to do that work.

Q. As I understood, you, you thought some committee could be appointed that would get up a plan that would meet with the approval of the Court and the approval of the Securities and Exchange Commission. I didn't hear you in your answer give any recognition to the necessity of getting the approval of two-thirds of the creditors, including secured contract holders that are secured by these deposits and getting their approval of a plan of reorganization. Did you have that in mind that that would be necessary in this court?

A. Yes, I have that in mind.

Q. You just overlooked mentioning that in your answer.

A. No. Naturally any plan that meets with the approval [fol. 1790] of the reorganization committee and the Audi-

tor of this State and the SEC will receive very favorable consideration by the contract holders.

Q. Now, suppose, Mr. Burt, that under the laws of some twelve states other than the State of West Virginia there are, as I have put in my previous question, about ten million dollars of these assets being held to secure the liabilities of this company to contract holders who have their money in it, would you think that a plan that involved the cutting down or reducing of the claims of those contract holders—those secured contract holders—in those deposited funds would likely meet with their approval?

A. There again you are getting back to the plan. Now, I am not going to discuss the plan. That plan will have to be worked out by a committee, and it will have to meet the situation, and if it is approved, as I said, I think the contract holders in all the states will be so glad to have it, rather than a liquidation, that more than sixty-six and two-thirds per cent will approve it.

Q. I understand that you would agree with me that in [fol. 1791] forming an opinion as to the reasonableness and the prospect of a plan of reorganization, that we have to weigh the present situation with which we are dealing with respect to the assets of the company and how the assets are held.

A. The committee will do that.

Q. You mean that you don't think that you should do that in expressing an opinion as to whether or not there should be a reorganization?

A. No, I don't think so. This plan is in the air yet; it is not formulated; it depends on a great many factors, including state laws and national laws and the approval of supervisory boards, and I am not going to attempt to make a plan on this witness stand.

Q. I think you recognized that there was a need for a considerable amount of new capital?

A. Yes.

Q. How much new capital do you think would be needed?

A. I don't know. It changes from time to time; our securities list is up and down. We are at the moment in an advancing market. As soon as this tax bill is finally passed, investment funds will probably come out. There is a rea- [fol. 1792] sonable hope, at least, that securities will sell higher in six months than they are doing today. The port-

folio might appreciate somewhat. I don't know what this committee might face.

Q. Do you know at the present time how much the deficiency is——.

A. I do not.

Q. Well, wait. You haven't heard my question.

A. Pardon me.

Q. Do you know at the present time how much the deficiency is between the reserves—invested reserves—and assets of the company—on the outstanding contracts—and the cash liabilities or reserve liabilities of the contract holder.

A. I do not.

Q. Sir?

A. I do not.

Q. You didn't know that that was about at least as much as $2,600,000?

A. I did not. I understand——

Q. In your opinion, would there be a fair chance of reorganization, of getting the approval of the Auditor of the [fol. 1793] State of West Virginia and the Securities and Exchange Commission and two-thirds of these contract holders—these secured contract holders—to a plan of reorganization that did not bring up these reserves to the liabilities of the company, reorganizing it as a solvent company?

A. There is again your plan. You are trying to get me to discuss the plan, which I will not discuss.

Q. Then you recognize that there is a problem of getting the new capital?

A. Certainly.

Q. Do you think that anybody would want to invest his money—any prudent business man—in putting in two or three or four million dollars in a company if that is the situation, if there is that deficiency of $2,600,000 between reserves and liability?

The Court: Mr. Farmer, there is no intimation that anybody will ever have to do that, or that anybody will be foolish enough to do that, so let's ask reasonable questions.

Mr. Farmer: If the Court please, I believe that is reasonable.

[fol. 1794] The Court: I don't.

Mr. Farmer:

Q. Wouldn't that either have to be done or wouldn't you have to bring your liabilities down to your assets?

The Court: We all know nobody is going to give this company two and a half million dollars to make up its deficit. Why ask a question that involves such an unreasonable thing as that?

Mr. Farmer: We also know, if the Court please, that nobody would reorganize it except as a solvent company.

The Court: That involves a lot of considerations, such as ascertaining just what the rights of the contract holders are and if their rights have already been depreciated to the extent of two and a half million there is no argument that I can see that they would expect that to be increased.

Mr. Farmer: Then there would be only one way to do it, and that would be to bring liabilities down to assets, wouldn't it?

The Court: Perhaps so. I do not object to you developing whatever you please, only please don't go into any [fols. 1795-1811] unreasonable and chimerical series of questions. Confine yourself to the practical aspect of this question.

Mr. Farmer: I submit, if the Court please, that is the most practical question we have got.

The Court: You know nobody is going to put in two and a half million dollars or give it to this company.

Mr. Farmer: Yes, sir.

The Court: You know that nobody in this room thinks that anybody would do that.

Mr. Farmer: Yes, sir.

The Court: Why ask the question, then, of this witness?

Mr. Farmer: And I also think that the contract holders aren't going to contribute it by voluntarily reducing their claims on the assets.

The Court: You can argue that, but don't go into it with this witness.

Mr. Farmer: I just wanted to test out the basis of his opinion of the desirability of reorganization.

. . . . . .

[fol. 1812] Q. All right, sir. You said one time you bought a contract, and you liked the way you got these notices.

[fol. 1813] A. Yes.

Q. Did you own any contract at the time this company went into receivership?

A. I don't know.

Q. Sir?

A. I don't know.

Q. When was the last time you held a contract?

A. I don't know that.

Q. Can you look that up and tell us?

A. I don't know whether I can or not.

Q. How much did you ever hold?

(No answer.)

Q. Well, I will ask you to do this. I see you are pausing——

A. I don't know. I had several contracts. Some I bought for my children and some for Mrs. Burt, but I can't tell when I bought them or what I paid on them.

Q. I want to ask you to do this, please, sir. During the noon hour, to look up the information and then give it to us after lunch, the dates and amounts of all the contracts that you or any member of the family of you bought and [fol. 1814] the dates when you cashed them in, if you cashed them in.

Mr. Ray: Your Honor, that is an unreasonable request. Mr. Burt lives in Wheeling. Undoubtedly all his records are at Wheeling; and I don't think those things have any place in this case at all.

Mr. Farmer: Could you get that for us, Mr. Burt?

The Court: Mr. Farmer, that would have pertinency only to the extent whether Mr. Burt owned any contract at the time of the receivership, and possibly whether he had cashed in any contracts before their maturity prior to the receivership. If you will confine it to that, I will admit it.

Mr. Farmer: I had in mind, if the Court please, it was a very practical test of his faith in this sort of savings institution.

The Witness: Not necessarily.

Mr. Farmer: I just thought that would be some test.

The Witness: Not necessarily. I might have needed some money.

Mr. Farmer: Well, can you get that information for us, Mr. Burt?

[fols. 1815-1819] A. I don't think I can.

* * * * * * *

[fol. 1820] Q. Mr. Burt, all these parties in interest that you thought should get together on this, have you considered the various state authorities such as the Banking Commission of Wisconsin and the authorities of the twenty-nine states in which this company was licensed to do business?

A. Not particularly.

Q. Why have you not considered them?

A. I think the federal court would handle this thing very much better than the rather selfish interests of the various states. Each state has its own interests and is not [fol. 1821] particularly interested in the other states nor in the contract holders as a body.

Q. Let's go into that a bit. Are you familiar with the nature of the laws under which the company operated in Wisconsin?

A. I am not a lawyer.

Q. You know they had a deposit out there?

A. Yes, sir.

Q. And did you know that that deposit was supposed to secure the payment of those contract liabilities in full out there?

A. I didn't know what percentage they deposited out there. I say I am not a lawyer.

Q. Mr. Burt, when you talked about some selfishness existing out in the states, did you refer to the contract holders or to state authorities who are attempting to protect the contract holders in their various states?

A. I think some of the states are trying to grab off assets of this company in excess of their requirements.

Q. Will you explain that further? I don't understand it.

[fol. 1822] A. Well, some of the states probably have, at the market values today, deposited with them more money than will be needed to carry out the contracts in those states.

Q. And who do you think is trying to grab off anything——

Mr. T. C. Townsend: Let him answer. I don't think he finished his answer.

The Witness: In the interests of all the contract holders, I don't think any state should be permitted to appropriate unto itself and its contract holders money in excess of the amount required to satisfy the claims in that state.

Mr. Lauritzen: Yes, now if there is an excess in any state, just who is it that you have an idea is trying to appropriate that excess? Is it the state as a body or some individual in those states?

A. My reason for preferring the federal court——

Mr. Lauritzen: Just a minute. Read the question, please.

(The question was read.)

[fol. 1823] A. The funds have been tied up, as I understand it, in some of the states.

Q. Yes, sir.

A. They are out of the control of the company, and at the moment, if state procedure continues will be under the control of those states. That might end to the detriment of all the contract holders, because of the fact that much of the excess would be—I won't use the word "wasted", but would be used in litigation of various sorts in those states in the state courts; and the one thing from which this company has suffered more than anything else in the last four or five years has been continued and expensive litigation. The directors and officers of this company have worked for a mere pittance, but the legal fees we have had have simply been outrageous; but if they have proceedings in twenty-nine states there is no hope whatever of reorganization and the contract holders' money will be gradually frittered away.

Q. You believe in the obligation of contracts, I think, don't you?

A. Yes, sir.

[fol. 1824] Q. As a businessman and director of various corporations?

(No answer.)

Q. When you buy something from a company you like to see the deal carried through per agreement, don't you?

A. Certainly.

Q. Are you familiar with the fact that out in Wisconsin and other states these contracts were sold on the repre-

sentation that there was a law in those states, which in the event of default of these contracts, would go into operation and permit liquidation of those funds under state authority and the payment to the contract holders of the value of their contracts?

A. I don't know on what basis they were sold out there.

Q. Well, if I told you that that was the basis that they were sold on, you would believe that it was reasonable to believe that that was the basis they were sold on, wouldn't you?

A. I don't know. We had a thousand salesmen out selling these contracts. I don't know on what basis they [fol. 1825] sold them.

Q. As an officer and director of this company, did you feel it your duty to ascertain what representations were being made to purchasers of these contracts?

A. We had a regularly organized company to look after those sales. We had a regular organization to do that work.

Q. Yes, and they were doing it on your behalf, weren't they?

A. They were doing it on behalf of the corporation.

Q. Of Fidelity, yes. Didn't you deem it encumbent upon you to look into those sales methods?

A. Of course we did.

Q. You knew they were operating under deposit laws in various states?

A. Certainly.

Q. And you knew they were representing to purchasers regarding the existence of those laws, didn't you?

A. We didn't make the sales. I didn't present a contract to a single soul. I don't know what the salesmen told them.

Q. If I told you that the salesmen did tell them that [fol. 1826] would you believe me?

A. I still don't know.

Mr. Ray: Your Honor, that is not pertinent.

The Court: No, I know of nothing in this record to base that on.

Mr. Lauritzen:

Q. Mr. Burt, if you were a contract holder out in Wisconsin and you had a Wisconsin law to protect you which formed the basis or part of the basis of your agreement

with Fidelity, and this company went insolvent, you would be quite interested to see that law enforced, wouldn't you?

Mr. Ray: Your Honor, that is an obvious question.

The Court: What is the question?

(The first part of the question was read as follows: "Mr. Burt, if you were a contract holder out in Wisconsin" * * *)

The Court: I will sustain the objection.

Mr. Lauritzen: When you talk about states grabbing off excess, do you mean that there are some lawyers out in those states who are seeking fees in liquidation proceedings out there?

A. I mean that if this estate, whatever you choose to [fol. 1827] call it, of some twenty-odd million dollars, is administered in twenty-nine states, a large part of the assets will be wasted in a duplication of legal cases and so on, and there will be undoubtedly—I wouldn't say it about any lawyer in this room, but there would undoubtedly be lawyers who will take advantage of the situation in order to fatten their own purses.

Q. Let me call your attention to the fact that there are deposits in only fifteen states instead of twenty-nine.

A. There are still plenty left.

Q. Are you familiar with the fact that in the State of Wisconsin, Ohio, and numerous other states having deposits the legal proceedings are being handled by the offices of the respective attorneys general of those states?

A. Up until this time, is that the case?

Q. I am asking you whether you are familiar with that fact.

A. No, I am not.

Q. If you were familiar with that one fact and knew the state officials were acting to the best of their ability [fol. 1828] to protect their people, it would change your answer as to such a state, that there was going to be any wastage.

Mr. Ray: Objected to as purely argumentative.

The Court: Sustained. I know of nothing in the evidence to sustain that.

Mr. Lauritzen: Your Honor, the appearance of counsel in this case shows clearly that the attorneys general of

all the various states are representing the state authorities out there in proceedings brought for the benefit of those contract holders.

The Court: It shows just what it shows on the record, that you are appearing here for them.

Mr. Palmer: Your Honor, May I suggest that the various state laws, the Court takes judicial notice of those, the laws of the various states which make what provision, that the state officials, by virtue of their salaries and by virtue of their election to the positions which they hold, shall take charge of it; and while the state statutes are not in evidence, yet I believe the Court will take judicial knowledge of the statutes of all states, and therefore the [fol 1829] question would be proper.

Mr. Huwe: Your Honor, I wonder if Mr. Thomas and Mr. H. Isaiah Smith are going to serve without fees in this West Virginia matter, and that whether that is a very relevant consideration in this case.

Mr. Lauritzen: Mr. Huwe, my question was directed to those states in which the attorneys general were handling the proceedings on behalf of the contract holders and acting under the state statutes.

Mr. Huwe: I realize that the three states you speak of have complete machinery for liquidating and that they do not appoint outside receivers. Ohio can liquidate without appointing an outside receiver—I can't speak for any other state, but I know they can liquidate, because that was decided by a cross petition filed by Mr. Rivers in a state case, and I think they convinced us thoroughly that they have exclusive machinery; but that does not apply to Mr. Palmer's statement, and I think his statement should be refuted.

The Court: Suspend just a minute, please.

(There was a pause in the proceeding.)

[fol. 1830] Mr. Lauritzen: May I have the question?

(The question was read.)

Mr. Palmer: I think there was an objection to that question that was sustained, Your Honor.

The Court: I will let him answer the question to save time.

A. I tried to cover that in a general statement.

Mr. Lauritzen:

Q. I want you to be specific, in view of my last question.

A. I have no feeling that the attorneys general of the various states would waste any money if that is what you mean. I am not afraid of that, but I am afraid of other proceedings that might arise under the state laws of various states. Fidelity formerly dealt with the states until the passage of the Securities and Exchange Act and since then——

Q. Just a moment, Mr.——

The Court: Let him finish his answer, and then you can ask the question.

Mr. Lauritzen: I just wondered if he is not referring to the wrong law.

The Witness: You mean the more recent Investment [fol. 1831] Act?

Mr. Lauritzen: Yes.

A. At any rate, the SEC first assumed jurisdiction over Fidelity under the old law and brought proceedings against it. Now, of necessity, Fidelity must deal from now on with the United States Government as well as the states, and for that reason as well as the one I stated a while ago, I think it would be very wasteful to have a multiplicity of legal proceedings in all these states. There are only three states which are represented out of the fifteen, are there not, here?

Mr. Lauritzen: Oh, no, sir, Illinois, Ohio, Wisconsin, Tennessee——

The Witness: Four.

Mr. Lauritzen: Missouri, Kansas.

The Court: I understand Mr. Burt is inquiring how many states are represented here by attorneys general only. He says there are three. I think he has the right to ask you.

Mr. Lauritzen: Then I will tell him if I can.

The Court: All right.

Mr. Lauritzen: Wisconsin, Illinois, Ohio, Kansas.

[fol. 1832] The Court: Who represents Kansas?

Mr. Lauritzen: Mr. Swarmer.

The Court: Where is he?

Mr. Lauritzen: He has not appeared at the resumption of this hearing, but he has his pleading-in and he is an officer of the state.

The Court: All right; go ahead.

Mr. Lauritzen: Auditor Sims and Mr. Meadows of West Virginia, representing the West Virginia State Auditor; Iowa represented by myself at this hearing at no charge to the State of Iowa; Pennsylvania was here represented by an assistant attorney general.

The Court: Can you assure this witness in connection with your questions that there will be no charges to the fund in any of those states?

Mr. Lauritzen: No charges for legal services so far as I know.

The Court: Or receivers?

Mr. Lauritzen: In some states I understand they have receivers. In our state the Banking Commissioner of Wisconsin administers the fund.

The Court: The point is, is there to be any charge what-
[fol. 1833] ever in those states for expenses of liquidation?

Mr. Lauritzen: For expenses, yes, sir; for fees, no.

The Court: In any of the states you mentioned?

Mr. Lauritzen: I am afraid I couldn't answer that.

The Court: Then why ask the witness a question based on that when you yourself don't know it?

Mr. Lauritzen: Can't I ask him with respect to a state where I do know the situation?

The Court: Yes, sir, and in connection with your question I want you to give your assurance to this witness that there will be no fees whatsoever of the kind he has in mind.

Mr. Lauritzen:

Q. What sort of fees do you have in mind, Mr. Burt?

A. It was testified here yesterday, I think, that we paid $48,000 in legal fees in a proceeding. The point I mention, the legal fees and the court costs and the things that go with continued litigation are draining this company of its assets, much to the detriment of the contract holders. You have mentioned probably ten states that are right
[fol. 1834] here in this room. There are others that are not. Now, if we are to get anywhere with the rehabilitation of this company and the protection of the contract holders, there must be some central authority in control of it.

Q. You don't know whether the state authorities agree with you on that?

A. I would expect them not to.

Q. Do you have any idea whether they are acting in bad faith with respect to their sworn duty and their duty to the contract holders in their states?

A. I think the attorneys general undoubtedly are acting in good faith, but that won't estop other suits in those states.

Q. And it wouldn't stop any suits here, would it?

(No answer.)

Q. There are eighty thousand contract holders, and I take it all of them would have to be represented here either by committee or personally.

A. No, I think if the case was placed in the federal court the contract holders would feel it was in proper hands and probably not bring any scattered litigation, all over the country. If we have to defend ourselves in all the twenty-[fols. 1835-1871] odd states in which we do business, the contract holders' money will certainly be much less than if we handle it through the federal court alone.

* * * * * * *

[fols. 1872-1877] JOHN MARSHALL, SR., called as a witness, testified as follows:

Cross examination.

* * * * * * *

[fol. 1878] The Court: I understood he said he had received some personal communication from the Securities and Exchange Commission.

The Witness: The point I was trying to make was that I had given this information in respect to this letter to the meeting, which I did; and other directors can testify on that. That was the point I was driving at. I didn't know the attitude of the Commission at our first directors' meeting. That was one of the things that was discussed. That was one of the reasons that actuated me in what might be called a change of front.

[fol. 1879] Mr. Palmer: That is why we think it is important, Your Honor——

The Witness: Even if I lied about the letter, I did it at the meeting.

Mr. Farmer: What did you say about lying about the letter?

The Witness: I say even if I didn't receive the letter I told the meeting I had. That was the point I was trying to make. That was one of the things that influenced the decision at that meeting.

The Court: I think it is proper for the Court to see the letter in view of the various statements made.

The Witness: I would be interested in having Mr. Palmer, if the Court thought it proper, tell who gave him the information, because I think it would throw a very interesting sidelight on this proceeding.

Mr. Farmer: I think that is an extraordinary requirement on the part of the witness.

The Witness: There is certain information I understand attorneys receive which is confidential, and I am sure I can guess who gave Mr. Palmer the information, and I think [fols. 1880-1881] he would be greatly embarrassed in telling it.

* * * * * * *

[fol. 1882] Howard E. Reed, called as witness by the debtor, having been duly sworn, testified as follows:

Direct examination.

By Mr. Ray:

Q. Please state your name.
A. Howard E. Reed.
Q. Your age?
A. Fifty-six.
Q. Where do you live?
A. In Dormont, Pennsylvania.
Q. What is your occupation?
[fol. 1883] A. I am a public speaker.
Q. In what business have you engaged in the past?
A. I have been with the Fidelity Investment Association and the Fidelity Assurance Association and the Fidel Association of New York as an officer and representative of the field organization.
Q. Previous to your association with Fidelity were you connected with any other business enterprises or banks?
A. I was vice-president of the Union Trust Company of Pittsburgh, Pittsburgh correspondent of the Guaranty

Trust Company of New York, and assistant cashier of the Union National Bank of Pittsburgh.

Q. How long were you associated with the Fidelity company?

A. Since November, 1923.

Q. What offices, if any, have you held with Fidelity?

A. My only office has been vice-president in charge of bank and public relations.

Q. Are you now a director?

A. Yes, sir.

Q. How long have you been on the board of directors?

[fol. 1884] A. I was on the board for a few years and then back, I would say from '28—from '26 to 1929, and then I was asked to resign and reelected to the board about 1937.

Q. I believe you stated that you represented the field organization of Fidelity. Just what do you mean by the field organization?

A. I was the contact for the home office in the field, representing most times the vice-president in charge of sales.

Q. Will you state briefly just what duties you performed?

A. My main duties were to visit those offices which were not being satisfactorily operated, contacting the supervisors, managers and men, calling upon the Better Business Bureaus, Chambers of Commerce, banks and banking organizations.

Q. What, in your opinion, have been the chief difficulties of Fidelity during the past two years?

A. Well, I think that Fidelity has—the board of directors recognized that we had three problems. First, we had an agency note amounting to in excess of a million [fol. 1885] one hundred thousand dollars and we recognized this by taking from the stockholders' or general account enough money to reduce it to $750,000, and had we continued at the normal pace it was the intention of the board to ultimately retire that note. In addition, we recognized the condition of the special income reserve. Under a previous administration the securities in that reserve had been sold, and it gave us very little with which to work. Recognizing the difficulties in connection with that reserve, we took from the stockholders' account a considerable sum of money and placed in that reserve, and it was the object of the board of directors to continue to deposit funds in that reserve until such time as it would be solvent.

We recognized that we had outstanding some twenty or twenty-five million dollars of contracts on which the reserve basis was four and four and one-half per cent. Many of those contracts were sold during a period when Armstrong Cork Sevens, American Rolling Mills sixes, Aluminum Company's sevens, Gulf Oil sevens were offered on the market; and when we found that good bonds were [fol. 1886] selling on a basis yielding three and three and a quarter per cent our problem has been how best to meet a situation where the reserve is four and four and a half, when we can only realize three to three and a half per cent on our security values. However, it must be taken into consideration that we did earn on ten to twenty percent of the reserve approximately six per cent on loans to contract owners in those reserves, which did assist us greatly in building up the reserve for the assumed interest rate.

Q. During the last four years in which the company sold contracts, will you state how much per month the business increased?

A. I couldn't tell you how much per month, but when the sales organization was put in the charge of Mr. Evans, the vice-president in charge of agencies, I believe the volume—and it could be checked in the records—was approximately $700,000 per month. That grew until December, 1938, when the volume was on the basis of about $5,250,000 per month, and based on that volume our earnings would have shown a substantial increase—our operating earnings during 1939 and 1940. I estimate that the earnings would [fol. 1887] have been in 1941 between $500,000 and $750,000 on straight operations.

Q. That is inclusive of income on securities?

A. That did not—except those securities in the capital account.

Q. During the latter part of this period about which you have just testified, please state whether the sales organization operated at a profit or at a loss.

A. In 1935 and 6 the sales agency was operating at a loss of I would say approximately $100,000 a year, but by 1938 the sales agency was operating at a profit. I don't remember what the figures were, but I should say in 1938 the sales agency operated at a profit of $6,000.

Q. There has been some discussion here of turnover in sales representatives of Fidelity. What have you to say with regard to that?

A. Well, I think any sales organization such as ours—any specialty sales organization—has a large turnover. I have myself interviewed thousands of men. They may be fine appearing, they may have satisfactory educational, [fol. 1888] cultural and business background, and may look like successful men; but we have never yet found the prescription that would make them work, and unless they work they fail in our business, as they would fail in any business: and the turnover is due primarily to the fact that the most difficult thing in our business was to get people to work.

Q. Do you have any figures which would compare the turnover in the sales force with the turnover in the sales force of insurance companies?

A. I think they parallel. Of course, some insurance companies have recently adopted a plan of giving their men more and better training. I am happy to say that under the direction of Mr. Pulfer that was his objective. Our objective was to do everything we could to cut down the turnover, because the turnover is expensive. Every man that is recruited costs you a considerable amount of money, and we wanted to have a sales organization more stable; and we could do that because we had a problem in 1936 which was not similar to the problem we had in 1940. In 1936 we were showing a loss of approximately $100,000 a year. We had to do something and do it fast; and we [fol. 1889] built our sales organization as rapidly as we could. That meant fifty thousand miles a year travel for some of us while the hard work was being done, but we felt that we had reached the point where we could have some stabilization of our sales organization, and it was Mr. Pulfer's objective to do that, and he could submit to you many bulletins and letters that he wrote on that subject, Mr. Pulfer having been elected vice-president in charge of sales in April, 1940.

Q. It has been stated here today, Mr. Reed, that annuity contracts are no longer being sold by insurance companies. Do you know whether that is true or not?

A. Well, I know that they are being sold. Only week before last I was in Cleveland and contacted one of my former supervisors, Allen W. Carpenter. He is selling annuity contracts for the Franklin Life Insurance Company of Springfield, Illinois, a company in business some

forty-six years. One of our men formerly in business in Charleston sold annuity contracts for the Equitable Insurance Company of Iowa. One of our managers in New York is selling for the Columbia Life Insurance Company of Boston, Massachusetts, a very good company, because [fol. 1890] it is operating in New York state, which is the barometer.

Q. What have you to say with respect to the opportunities which Fidelity would have had to sell life insurance in addition to the special income contracts if it had been permitted to proceed?

A. Of course, I don't think there is any question but that it could have sold both life insurance and income reserve contracts. It was my duty to contact men in the field, and many of them were in almost daily communication with me, ready to start out in the field and demonstrate that they could be sold. As a matter of fact, they are being sold today by the Investors Syndicate, by these insurance companies, the Franklin Life Insurance Company—they just finished the best six months in their history, according to the statement which I received from them just a few days ago; and as I say, the proof of the pudding is the eating thereof.

Q. Will you tell us a little bit more about the business done by the Franklin Life Insurance Company during this past six months?

A. I couldn't possibly give you the figures.

Q. No, I mean the character——

[fol. 1891] A. Oh! well, they do a general life insurance business and they sell an annuity contract in which the payments are paid in for six years and then the annuities begin six years later, with cash surrender values, I believe, at the end of two years—beginning at the end of two years. I am not very familiar with terms of the contract, but I know those are some of the high spots.

Q. Mr. Reed, from your business experience in the past and from your knowledge of Fidelity and the character of its business, will you state whether or not, in your opinion, a plan of reorganization of Fidelity can be developed which will be practical and feasible?

A. I think it can.

Q. Do you care to make any statement of your reasons for your answer?

A. Well, of course my reasons are purely from the sales standpoint. I think that there is a great field in this country for an income contract—an income reserve contract. I don't believe that we have scratched the surface in sys-
[fol. 1892] tematic saving in this country. We are today reputed to be the greatest savings nation in the world, but the per capita savings as of June 30, 1940 were $196. So that there is yet a tremendous field for this business which has not been touched. Mr. Carpenter told me in Cleveland that he had made twenty-five interviews that week and in no instance did any man whom he interviewed mention defense bonds, so that we feel that there is still a great field for this business regardless of any so-called government competition.

Q. Then, in your opinion, Fidelity can be reorganized and rehabilitated under a proper plan of reorganization?

A. That is right.

Mr. Ray: That is all.

Cross-examination.

By Mr. Palmer:

Q. Mr. Reed, what was your official title for the work that you did with Fidelity?

A. My title was vice-president, which title was given me to increase my prestige with the field force and with the organizations which I contacted. I made a great many
[fol. 1893] speeches to Rotary Clubs, Kiwanis Clubs, bankers' associations and so on, and it gave our sales organization added impetus to advertise the fact that an officer of the company was to be present at a certain place at a certain time. I had no authority to sign checks. As a matter of fact, my vice-president's title was more honorary than——

Q. When did you first go with the company, Mr. Reed?

A. November 20, 1923.

Q. What position did you take with the company then?

A. I was a salesman—I was a representative in the Pittsburgh office. I soon became associate manager in the Pittsburgh office and was elected on the board and afterwards elected vice-president.

Q. When were you elected to the board of directors?

A. I believe in '25.

Q. That is the board of directors of Fidelity?

A. That is right.

Q. Your original employment was with the National Sales Company?

[fol. 1894] A. That is right.

Q. Not Fidelity?

A. That is right.

Q. And in 1936 what was your occupation with Fidelity?

A. Vice-president.

Q. In charge of sales?

A. No, sir. No, in charge of bank and public relations. Carroll D. Evans was vice-president in charge of sales.

Q. For how long a period of time did you work on commission with Fidelity—from when to when?

A. I would say approximately two years.

Q. When was that?

A. From '23 to '25.

Q. And after that time did you work entirely on salary?

A. Yes, sir.

Q. Did you ever receive any commissions at any time after that from either National Sales Company or Fidelity?

A. After 1925?

[fol. 1895] Q. Yes.

A. No, sir. Well, I may have sold two or three contracts on which I received a limited amount, probably not a hundred dollars. I purchased a number of contracts myself on which I did not take the commission.

Q. In 1936 there were seven officers in the sales end who were receiving more than $10,000 a year. Were you one of those?

A. No, sir.

Q. With reference to the note of the National Sales Agency——

Mr. Ray: I want to ask a question about those salaries. Where was that?

Mr. Palmer: I will find that, Mr. Ray. (A pause.) On page 105-106, beginning at the top of page 106, compensation paid by the association to employees other than officers and directors, reported for the year 1936 only. The sales representatives of the association up to September 7, 1934 were employees of the National Sales Agency, Incorporated. In 1936 seven employees of the association each re-

[fol. 1896] ceived more than $10,000 from the association. The combined total of the payments to such employees were $116,089; the two highest amounts paid were $25,777 and $22,741.

Mr. Ray: Where did you get the word "salary" which you used?

Mr. Palmer: If I used it I should have used "compensation."

Mr. Ray: I have no objection if you use "compensation".

The Court: I understood you said seven persons in the sales company.

Mr. Palmer: That is what I gather from this, Your Honor.

The Court: I don't gather that. That says seven employees of the association.

Mr. Palmer: But it spoke in the line before that of the sales representatives up to September 7th being employees of the National Sales Agency, and says this was compensation paid association employees other than officers, directors, reported in 1936, and I presumed they were talking about sales representatives.

Mr. Jaegerman: The sales company was not an associa-
[fol. 1897] tion but a company.

Mr. Palmer: But in 1934 the company took over the sales end of it.

The Court: As I say, it is possible to imply it from the language, but I believe you ought to be careful in quoting from that report to get what the report says, because otherwise it may be misleading to the Court in reading over the record.

Mr. Palmer: I am sorry if I did misquote it.

Q. Mr. Reed, were the seven employees who received more than $10,000 each in the year 1936 in the selling end of the association?

A. They were in the selling end of the association, and those figures do not mean anything, because they were all gross amounts paid to these men from which they had to pay their own travelling expenses and a great many other expenses in connection with their activities; and if you were to check their income tax records you would find their net was a great deal lower than that. There was a great deal of expense.

Q. They are still the amounts the company paid out to men in the selling end.

[fol. 1898] A. And we are only sorry that we couldn't pay them more, because they were on a straight commission basis, and the more business they did the more we paid them.

Q. And when the total commissions paid for the years 1927 to 1936 amounted to 18.9 cents per dollar, were you sorry that you couldn't pay more of the money out to each salesman from each dollar paid in by the investors?

A. Well, I don't know about the percentages, but the amount which we paid out—you must understand that our business was a highly competitive business, and we certainly couldn't—in order to compete with salesmen who are after positions with Investment Trusts and with the Investors' Syndicate and with the United Company of Kansas City and all of the life insurance companies, we had to pay a fee similar to—our setup was similar to those sales organizations of those companies.

The Court: Is that about the average that is paid to salesmen of all those companies in that same line of business?

[fol. 1899] A. Yes, Your Honor, just about the average. There may be some leeway one way or the other. Of course, in the insurance business they pay them considerably more than we did. We paid all our commissions in eight months, whereas insurance companies pay them over a period of nine or ten years.

Mr. Palmer:

Q. Do you mean to say, Mr. Reed, that any insurance company in the United States pays out probably 19% of its income over a ten-year period to its salesmen?

A. I don't know what percentage it pays over a ten year period, but I know that their commission rate eventually takes care of the entire initial payment of the insurance. That is the reason that an insurance *company* hasn't any cash surrender till after three years, and then it is very small, because for each $1,000 in liabilities an insurance company must pay $7.00 into the reserve at age thirty. All the rest is overhead and takes care of the supervisory cost, the manager, the collection agents and all the balance.

Q. Do you think any insurance company keeps as income [fol. 1900] twenty-five cents out of each dollar paid in today?

A. I can't answer that.

Q. Can you name me any insurance company that pays 19% of its income over a ten year period to its salesmen?

A. 19% of the income?

Q. Total income from premiums paid in.

A. I couldn't tell you on a percentage basis anything with reference to insurance payments. I know this, that practically the entire initial payment is used for overhead eventually, although it takes ten years to pay it out.

Q. Yes, but it doesn't take anything like 19% of the entire premiums paid in over ten years to do that.

A. I don't know what the percentages are.

Q. Now, with reference to this note of National Sales Company of which you were speaking, you stated that the money was taken from the general or stockholders' fund to pay off this note, didn't you?

A. That is right.

Q. Isn't it a fact that the note was transferred in 1936— [fol. 1901] this claim of the association against National Sales Agency, Incorporated, was split into two parts and transferred by the association to the Paull Company and the Marston Company, both wholly owned subsidiaries, and that the aggregate balance due December 31, 1936 was $858,-918.24, of which $731,636.39 was carried by Paull Company and $127,281.85 was carried by Marston Company; that these claims became part of the assets against which these subsidiaries issued collateral trust certificates to the association which had a face amount of $4,413,000 at December, 1936; that A. L. King, one of the major stockholders of the National Sales Agency, Incorporated, was vice-president and comptroller of the association December 31, 1936; that the only assets of National Sales Agency, Incorporated are the rights to commissions applicable to installments of certain outstanding certificates issued prior to September 7, 1934; that how much of the indebtedness can be ultimately paid off by the application of such commissions is conjectural; that during the years 1935 and 1936 the indebtedness was reduced from $1,048,402.81 to $858,918.24, a total re- [fol. 1902] duction of $189,000-odd dollars; that since the bulk of selling commissions are payable out of the early installments and sufficient time has elapsed to have cleared all payments on outstanding certificates not in arrears, it appears doubtful if this indebtedness will ever be substantially reduced? What have you to say about that?

Mr. Ray: What is inconsistent with what the wifness said?

Mr. Palmer: It was not paid out of the general fund.

Mr. Ray: Where did this say it was paid?

Mr. Palmer: Paid out of commissions on sales.

Mr. Ray: What is inconsistent?

Mr. Palmer: The inconsistency is that this witness has indicated that money already in the stockholders' or general fund was used to reduce this note when it wasn't the fact at all. The note was taken over and the commissions which later came in from sales already made by the National Sales Company were used to reduce the note instead of putting them in the general fund.

[fol. 1903] Mr. Ray: I don't remember anything the witness said about money already in the fund.

The Court: The witness said that originally this note amounted to more than eleven hundred thousand dollars, but it was reduced to $750,000 by payments from the general or stockholders' fund, but I don't remember his saying that it was money already there, although that may have been implied.

Mr. Palmer:

Q. And didn't you further say that if let alone the general or stockholders' fund would have continued until this note was paid off?

A. Yes, sir.

Q. Where were they going to get the money to do that?

A. From the earnings on operations.

Q. From the earnings on operations of what?

A. The Fidelity Investment Association.

Q. They didn't earn any money in the general fund in the last ten years, did they?

A. They were earning money in the general fund in '38.

Q. That is one year?

[fol. 1904] A. That is right. They earned considerable money in the general fund from security profits in many years, tremendous amounts of money. As you can see by the record, I think outside of one or two years their earnings were entirely satisfactory on the basis of relation to the common stock; and by increasing our volume $5,250,000 one month, which means $10,000,000 the second month and fifteen million the third month, and with the underwriting fees coming in, and with the idea that we can put on the books $6,000,000 without increasing our overhead in the home office, enabled us to make a profit per unit much

greater when we had a greater volume of business. Just as Henry Ford builds automobiles; if he built three or four it would cost a considerable sum of money, but by doing it the way he does it he was able to cut down the cost.

Q. Let's see if it wasn't sales talk like that that resulted in this. Immediately following what I read you before, on page 99,

"In its bill of complaint against Fidelity Investment Association, the Commission alleged that the management [fol. 1905] of the Association transferred certain questionable assets to Paull Company, Marston Corporation, and Marietta Company in order, among other things, 'to conceal the indebtedness of the insolvent and dormant National Sales Agency, Inc., to the General Fund and to the various Contract Funds'. In its answer, the Association denied that the subsidiaries named were organized to conceal the indebtedness as alleged. The final judgment of the District Court perpetually enjoined and restrained the Association, among other things, from 'creating or maintaining subsidiaries to conceal the nature or amount of indebtedness or investments, or employing any other device, scheme, or artifice to defraud.''

The Court: Mr. Palmer, I have said a good many times in the course of this hearing that I didn't want the questions to assume the character of that question and the questions you have been asking him. You are coupling up with a question to this witness extensive readings from that record, which the Court will read when the time comes, and for no other purpose that I can see than just to get them into the stenographer's record here, and all I can tell that that does [fol. 1906] is to increase the size of this record and the consequent expense. It certainly can't enlighten the Court for you to read that book and ask this witness if it is true or what he thinks about it. The record is in; the Court will read it; and I think that is enough.

Mr. Palmer: I am asking him the fact, Your Honor, if the answer he made just before in the nature of a sales talk as to what could happen to Fidelity, wasn't the very cause of such a decree having been entered in Detroit against it.

The Court: You might just as well say, "Wasn't it the cause of all this?" and then read that book to the Court, and I don't see any necessity of that.

Mr. Palmer: I wanted particularly as to this Sales Agency note, which the witness said could and would be reduced by the company, and gave a sales talk as to why it could be, to ask him if that wasn't the way the company got into this difficulty in Detroit.

Mr. Ray: I see no reason why Mr. Palmer should criticize the witness's testimony as being a sales talk.

[fol. 1907] The Court: I will sustain the objection to that question, and it is about time that we usually have an afternoon recess, so we will suspend and take a recess until 3:30.

(At 3:20 o'clock P. M., a recess was taken until 3:30 o'clock P. M.)

After Recess. 3:30 P. M.

Mr. Palmer:

Q. The next thing you said was wrong with the company was that from the general or stockholders' account an amount was put into the special income reserve. Is that correct?

A. That is right.

Q. Isn't it a fact that there has been evidence introduced here that if the special income reserve would pay the notes it owed the other funds it would be absolutely and wholly insolvent? By insolvent I mean it would have no assets.

Mr. Ray: I want to object to that question, Your Honor. How could this witness possibly be able to answer that question when the witnesses have been excluded from the court-room?

The Court: Sustained.

[fol. 1908] Mr. Palmer: This witness has been in the court room ever since he has been here, if Your Honor please.

The Court: It is not proper to ask him what evidence has been introduced in the case, if it is in.

Mr. Palmer: I was asking him if he didn't know that.

Read the question.

(The question was read.)

Mr. Palmer: The Court is correct.

Q. Mr. Reed, do you know that if the special income reserve would pay the notes it owes to the other funds that there would be nothing left in that reserve?

A. No, I don't know it.

Q. What was put in from the general account to the special income reserve?

A. You mean in amount?

Q. Yes.

A. I couldn't tell you the total amount. I know at one time it was as much as $200,000 in one year.

Q. Wasn't it put in from other accounts and a note given, [fol. 1909] instead of coming from the general account?

A. No, sir.

Q. Where did the notes come from that the special income reserve gave to the other fund?

A. Now you are asking me something that I am unable to answer, because you must understand that most of my time has been spent in the field, and that I did not have an insight into all the ramifications of the various reserves, beyond the general idea that the income reserve needed more funds, and from the earnings of securities in the general account we placed a certain proportion in that reserve. As to notes and the intricate bookkeeping I have no knowledge, because my time was spent in the field.

Q. All right, sir. And now you said one of the other troubles was that you had certain contracts that paid four and four and a half per cent improvement on the reserve which had been issued at earlier times when bonds yielded higher returns. Is that correct?

A. That is right. I assumed that rate.

Q. Beg pardon.

A. The rate was assumed at four and four and a half per [fol. 1910] cent. It was not the rate that we paid.

Q. You were familiar with the Series B income reserve policy were you not? Did you know that that contract upon maturity without the insurance feature yielded only 2.56%, and that it cashed in at the end of 126 months at a yield of 2.41%?

A. Yes, those figures were contained in the prospectus which we left with each contract owner who purchased a contract.

Q. Did you further know that with the insurance feature it yielded 1.55% at maturity and 1.34% at the end of 126 months?

A. Yes, sir.

Q. Would you produce for me the prospectus which was given to the prospect which contained those figures?

A. I haven't them.

Mr. Palmer: May I ask the debtor to produce such a one which advised the prospective purchaser of those yields? (A pause.) May I see one of the prospectuses we have? Perhaps that will answer our requirements. Mr. Schurr says it will take a little time to check that, but if we are [fol. 1911] unable to find that in any prospectus we have may we have that prospectus furnished, please?

The Court: Go ahead.

Mr. Palmer:

Q. Will you describe the prospectus, so the attorney for the debtor will know what type or sort to look for?

A. Well, it was a prospectus containing our financial statement, a record of the loading in the contract as to what the various amounts are allocated to, the basis of yield as outlined in your remarks and contained a slip, and the purchaser signed the slip, which became a part of our records indicating that he had received the prospectus.

Q. Can you tell us when that prospectus was issued, approximately?

A. When it was issued?

Q. Yes.

A. I would say it was issued about January, 1939.

Q. Then the fact that you had these contracts calling for an improvement of reserve at four and four and a half per cent was not one of your difficulties when the return that you were paying was 1.34 and 1.55 and these various other percentages? Isn't that true?

[fol. 1912] A. That is not true. The assumption of the reserve on a four and four and a half per cent basis means that we must earn all of the money over and above the loading on a four and four and a half per cent basis. The fact that we only returned to the contract owner these various yields hasn't anything to do with the fact that we assumed a four or four and a half per cent basis, anymore than your insurance is set aside on a three or three and a half per cent basis to you as an insurance holder over and above the amount deposited in the reserve per thousand may return you much less than 1%. As a matter of fact, I would like to get over to you the fact that I have made a study of thrift covering a great many years. I have talked to bankers' associations all over this country and to security commissioners' associations. A price appeal never made people

save money. If it did there wouldn't be any savings in the bank accounts today, and we know there are $25,750,000,000 in the savings banks in this country today, which is just about an all time peak. Back in 1915, when savings were 4% and 4½ and 5%, the total amount on deposit in sav- [fol. 1913] ings amounted to $7,700,000,000 so you see we never sold this business on price appeal any more than they ever sold insurance on price appeal.

Q. By price appeal you mean yield to the investor for the amount involved?

A. Correct.

Q. What was the primary selling feature, then?

A. The plan. The thing which made me buy one of these contracts after having worked in a bank twenty-two years during which time I was never able to save money despite the fact that savings department was located thirty feet from my desk—but by adopting this plan and maturing the size of the contract I was able to send our one son to Virginia Military Institute and Augusta Military Academmy, and I am sure if it had not been for the plan I would not have been able to do it.

Q. What do you mean by the plan?

A. The plan that calls for regular payments over a period of 126 months, when you receive a reminder each month, and when you know that if you stop paying there is a penalty to it, a plan of which the strongest feature is the fact [fol. 1914] that you can't get all of the money out for six or seven or eight years, is the kind of plan which makes people save money; and while thereare many flexible features in connection with the plan which we think takes care of every emergency, the fact that each month a *daily* reminder—the fact that fifty-eight bankers in the City of Pittsburgh carried this plan indicates that if they sent their money to Wheeling, West Virginia, instead of keeping it in their own saving accounts, it must be clear that they did it because of the plan, not because they do not trust their bank. The contract owners in the Union Trust Company of Pittsburgh, which has a capital of a million and a half and a surplus of eighty-seven and a half million certainly think their money in the bank is safe; the stock sells for $7,000 a share and it pays 206% annual dividends; but they like the plan, and senior officers in that bank have been carrying contracts with us for years, as well as with practically all the banks in Pittsburgh.

Q. If this plan was the main selling feature, why did one [fol. 1915] of your pro-pectuses have on it the capitol dome of West Virginia, citing part of the state laws of West Virginia as to how to secure these were, and put on a picture of a vault which stated it was a West Virginia vault where the securities would be kept in order that they would be safe?

A. My answer to that is that our sales promotion manager thought that was a fine thing to assist us in selling contracts. My own opinion is that it didn't sell any; that the contracts we sold out in Atcheson, Kansas, and up in LaCrosse, Wisconsin, were sold because they liked the plan. Many of them, I am quite sure, didn't know even where Wheeling, West Virginia, was located, but they liked the plan and the fact that the business was sold on the enthusiasm for the plan based upon most of us carrying it.

Q. Isn't it a fact that every salesman in Wisconsin carried as an integral part of his kit the Wisconsin deposit law, so that he could tell the prospect that that man was absolutely safe, because this money was backed up by the deposit of the State of Wisconsin, and that was given to him by the sales organization?

A. It may have been given to him by the sales supervisor [fol. 1916] of Wisconsin. I confess I have never seen that prospectus.

Q. Have you seen the salesman kits they were given?

A. I never have inspected any salesman's kits.

Q. So that your idea is that any rehabilitation which will incorporate a plan whereby the person will periodically save, and if they don't save the company will keep their money or take some of their money from them for failing to save, is a good idea?

A. Yes, sir. And so said by very great and prominent financiers, and even a president of the United States has said that the way to make people save money is to charge them something for doing so. As a matter of fact, today in many states Christmas Savings Funds are opened with a charge for operating them, whereas originally they were opened and paid 4% interest. Now they pay no interest but charge them. As a matter of fact, I have a friend in New York who gave everybody a fountain pen when they opened their savings account. He says now he would be glad to give them a pencil to match it if they came in and closed it.

Q. Does that mean that that man feels that the bank can't [fol. 1917] make money on deposits made with his bank?

A. I don't think there is any question of it.

Q. Then how do you expect a company to be formed now to compete with those banks to be able to make money as a bank can't?

A. Because a bank must set aside a certain reserve by law, if they are a member of the Federal Reserve system, as high now as 16½% of their net deposits, with the Chairman of the Federal Reserve Board advocating that it be increased. We had no problem of that kind. A bank had to keep a tremendous amount of cash on hand for each and every emergency. We have no problem of that kind. Practically all of our reserve—100% of the reserve—goes to work in our business. We can't be compared to a savings account in a bank any more than we can be compared to a defense bond, in which all of the overhead and all of the expense in connection with the defense bond comes from the taxpayers.

Q. They have a great advantage on you in that defense bond.

A. They have an advantage over every form if they sell [fols. 1918-1921] it. I had the pleasure of making the first speech to the employees of the Federal Reserve system on thrift and defense bonds. We are all in favor of people buying defense bonds, but the total amount bought in July of the Series A amounted to $92,000,000 which is less than seventy-five cents per capita.

* * * * * * *

[fol. 1922] Q. Your business was that of public speaker?

A. Yes, sir.

Q. And since 1923 you have more or less been in the business of advocating people investing their money in this investment certificate?

A. Not on the public platform.

Q. Sir?

A. Not on the public platform.

[fols. 1923-1933] Q. You mean not on the public platform all that time?

A. No, you asked me if I was in the business of being a public speaker, and then you asked me if I had advocated people buying this plan, and I tied the two to-

gether, and I want to emphasize that any public address I have made has never had anything to do with this plan.

Q. I thought you said you had appeared before Chambers of Commerce and securities and insurance commissioners' meetings and spoken.

A. But not on this plan, except at a convention of the National Association of Securities Commissioners at New Orleans, when I followed Mr. Landis, the Chairman of the Securities and Exchange Commission, and then I spoke at their request on the Fidelity plan. Never in any public place have I advocated that anybody adopt our plan.

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[fol. 1934] C. E. Smith, recalled, testified as follows:

Direct examination.

By Mr. Ray:

Q. Mr. Smith, I have been advised that among the assets in the Southern District of West Virginia there are approximately a million dollars of those assets evidenced by certificates of stock issued to Fidelity Investment Association or Fidelity Assurance Association, on which certificates the assignments on the back have not been executed by Fidelity Assurance Association. Is that cor-
[fol. 1935] rect?

A. I don't think the amount of a million dollars is quite correct. That is based on market value. I had occasion to check that today, and the stocks on deposit with West Virginia have a market value of approximately $600,000. Of that amount some of the stock certificates are registered in Marston Corporation and Paull Company and to those are affixed, for the most part, blank stock powers which are executed. I believe if you did not consider those that the market value of the stocks registered in the name of Fidelity Investment Association would be about $500,000, as compared with $11,000,000 in round figures, or rather $9,000,000 in round figures on deposit in Charleston.

Q. But those that are issued to Fidelity Assurance Association are not endorsed on the back thereof?

A. No, they are not endorsed.

Mr. Ray: That is all.

(Witness stands aside.)

Mr. Ray: I have one exhibit to introduce by Mr. Gribben. May I call him a little out of order and get rid of that?

[fols. 1936-1947] The Court: All right.

Mr. Reinhardt: If Your Honor please, while we are waiting for Mr. Gribben, I will take the opportunity to offer in evidence five papers that Mr. Thomas has furnished me which are copies of papers that are in the record in the state receivership proceedings of West Virginia. We can mark them all as one exhibit and letter the individual papers.

The Court: That is a good way to do it.

Exhibit 70

The papers referred to were admitted in evidence, as Exhibit 70, and the individual papers letter a, b, c and d. The same are attached hereto as a part hereof.

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WALTER J. GRIBBEN, recalled, testified as follows:

* * * * * * * * *

[fol. 1948] Mr. Palmer: Do you show in 1932 what I have just read?

A. The $5,000 that is shown in the directors' minutes was paid to Sanders, Childs, Bobb and Wescot in two checks, one of $3,850.58, and the other $2500, which also includes the $5,000 and other expenses.

Q. My question is, was Mr. John Marshall's name included in your report on that as it is in the minutes of the board of directors?

The Court: What difference does that make?

Mr. Palmer: The inaccuracy of it.

The Court: We are not investigating inaccuracies in the minute book.

Mr. Palmer: We don't want a report submitted here which is inaccurate.

Mr. Ray: Which is more accurate, the cancelled check or the minute book?

Mr. Palmer: I don't know. Which is?

Mr. Ray: I should say the cancelled check.

[fol. 1949] The Court: If objection is made I will sustain the objection to any other question along this line that is not directed to whether or not these expenses were abnormal.

Mr. Palmer: If Your Honor please, I want to object to the Court's ruling in connection with leaving in evidence in this record the fees of Koontz and Koontz insofar as they may or may not concern the suitability of Mr. Ross Thomas as a receiver, for this reason. Until there has been some evidence, or iota of evidence, by any witness produced by the debtor that the fees were either excessive as paid to that firm or that work was not done for the amounts rendered, there is nothing for the Court to consider in the way of suitability. In other words, if these fees were paid for work done and necessarily done at the debtor's request, that would bear no relationship of any kind as to the suitability of Mr. Thomas as a state court receiver, and until there has been more evidence produced or an indication that it will be produced, I move that that be the same as the other fees.

The Court: The Court's holding on that is this. Any [fol. 1950] matter that would tend to show the connection of the firm of Koontz and Koontz with the old Fidelity company, the extent of those connections, the duration and so forth, I feel ought to be considered by me in the matter of determining whether or not a receivership with one of the firm of Koontz and Koontz acting as receiver is a suitable means of taking care of the interests of all parties concerned. Now, I say that, beca-se, as I stated from the beginning, so long as the proceeding is in this court I have no intention of letting any person who has been connected with the affairs of the company heretofore and has any responsibility whatever for getting it into the shape that it got in have anything to do with the reorganization process, if that is proceeded with, and I must bear in mind that Chapter 10 of the reorganization statute is very specific in prohibiting any connection with the trustee of any person who is interested in the debtor corporation. Now, if Chapter 10 is so specific in that respect, it seems to me it evidences a policy on the part of the United States to keep receiverships and trusteeships in cases of this kind out of [fol. 1951] the hands of those who have formerly been connected with the company. To that extent the evidence will be considered in determining that question.

Mr. Palmer: May I suggest to the Court that there has as yet been no evidence produced by anyone that Mr. Koontz or any member of his firm had anything to do with any wrong management of this company; and for the Court

to keep the matter of the question of fees in the record on the possible question of any wrong management by Mr. Koontz or his firm, until such evidence has been produced, I think would be improper.

The Court: I recall one statement made by your client, or a client that you are speaking for, the State Auditor, to the effect that the attorneys' fees paid to Koontz and Koontz were outrageous. I don't know how else to interpret that.

Mr. Palmer: I think, if Your Honor please, if you will recall the question asked Mr. Sims was if there were a certain number of thousands dollars of attorneys' fees paid, what he thought of that. He was not asked, "Do [fol. 1952] you know what work the firm of Koontz and Koontz performed or what they were paid." The name was carefully kept from Mr. Sims as to whom those attorney fees had been paid.

The Court: He seemed to indicate he didn't care who got it, he thought it was outrageous.

Mr. Palmer: He seemed to think there was too much attorneys' fees charged in general.

The Court: Well, he used the word outrageous. The Court, in considering the matter, of course will give whatever weight the evidence appears to be entitled to, but I think it does have a bearing and ought to be left in.

Mr. Palmer: May I state to the Court that there is no prohibition in any state court of the debtor's attorneys acting as receivers for the debtor? In fact, it is a very common practice to appoint them as receivers for the debtor.

The Court: A practice that has been frowned on many times by the courts.

Mr. Palmer: In federal court proceedings, but never in state court proceedings that I recall; and for that reason [fol. 1953] we renew our motion.

The Court: I overrule the motion.

Mr. Palmer: I would like a specific exception to the Court's ruling in that regard.

* * * * * * *

[fol. 1954] F. J. McNULTY recalled, testified as follows:

Cross-examination.

By Mr. Jaegerman:

Q. Mr. McNulty, when you were here last as a witness you were requested by the various representatives of certain states to bring with you or to furnish the Court with copies of the various forms of monthly reports that were sent to states having deposits of Fidelity securities.

A. Yes.

Q. Have you brought those with you?

A. Yes, sir, I have. Now, in this regard, I didn't make complete copies of each month's reports, but I took what could be termed typical copies of the reports and letters which were sent out each month, and going back over a number of years to 1935——

Q. Take, for example, the State of Missouri. You have examined your files for the State of Missouri and have brought with you what you consider representative copies [fol. 1955] of all forms or deposit notices sent to the State of Missouri?

A. Yes, sir.

Q. Did you do the same thing for the State of Wisconsin?

A. Yes, sir.

Q. May I have that?

(Witness produces paper.)

Q. Did you do the same thing for the State of Illinois?

A. Yes, sir. (Producing paper.)

Q. Did you bring some other representative states?

A. I have forms here for the State of Iowa, Alabama, Kentucky and Tennessee.

Mr. Jaegerman: Would any state representative or any party care to examine these files?

Mr. Farmer: The Tennessee file.

Mr. Jaegerman: I am informed by Mr. Schurr, who represents the Securities Commission of the State of Missouri, that he is satisfied with this file that has been brought by Mr. McNulty, and I will offer it as an exhibit.

[fol. 1956] Mr. Schurr: I don't know whether those figures are correct, but that is the type of report that was forwarded.

Mr. Jaegerman: May this be admitted, Your Honor, as Exhibit 72?

The Court: All right.

Exhibit 72

The papers referred to were admitted in evidence, marked as above indicated, and are attached hereto as a part hereof.

Mr. Jaegerman: I understand the State of Illinois is satisfied that this is the type of statement furnished the State of Illinois, and I offer this as Exhibit 73.

Exhibit 73

The papers referred to were admitted in evidence, marked as above indicated, and are attached hereto as a part hereof.

Mr. Jaegerman: Mr. Lauritzen, representing the State of Iowa, says he has no objection to this file going into evidence. I offer it as Exhibit 74.

Mr. Lauritzen: May I say for the record that I have no [fol. 1957] information whatever as to those reports. I represent Iowa here at their request, but I have been furnished with no information upon this subject.

The Court: How about the one in relation to Wisconsin?

Mr. Lauritzen: I am just checking those now, Your Honor, with the records I have here.

Exhibit 74

The papers referred to relating to the State of Iowa were admitted in evidence, marked as above indicated, and the same are attached hereto as a part hereof.

Mr. Jaegerman: I offer as Exhibit 75 the forms for Alabama, and the forms for Kentucky as Exhibit 76, merely as being representative of whatever assistance they may be for the record.

Exhibits 75 and 76

The papers referred to were admitted in evidence, marked respectively as above indicated, and the same are attached hereto as a part hereof.

Mr. Jaegerman: I am informed by Mr. Farmer that he has no objection to this Tennessee file being admitted in [fol. 1958] evidence, and therefore offer it as Exhibit 77.

Exhibit 77

The papers referred to were admitted in evidence, marked as above indicated, and the same are attached hereto as a part hereof.

Mr. Jaegerman:

Q. Concerning the Wisconsin file, Mr. McNulty, does this contain a copy of every deposit form or notice sent to the State of Wisconsin from 1935 to date?

A. Yes, that was typical of the usual monthly report.

Q. It does not contain every monthly report, but contains representative months?

A. Yes, sir, I have reports like this in our files monthly.

Q. Were reports sent monthly to Wisconsin or were semi-annual reports sent to Wisconsin in the early years?

A. No, from back in 1935 a monthly report has been furnished, to my recollection and knowledge.

Mr. Jaegerman: I offer this Wisconsin file as Exhibit 78.

[fol. 1959] Exhibit 78

The papers referred to were admitted in evidence, marked as above indicated, and the same are attached hereto as a part hereof.

Q. Mr. McNulty, did you also furnish certain states with copies of the annual audit of Fidelity Investment Association?

A. Yes, sir.

Q. In past years?

A. Yes, sir.

Q. Do you have a schedule with you showing what states received all the annual reports?

A. Yes, sir, I have a schedule here going back through the year 1937, but I have letters or copies of transmittal here that go back in '35 and '36.

Q. The states that are represented in this schedule and on this file are Alabama, Connecticut, Delaware, Georgia, Illinois, Indiana, Kentucky, Missouri, Ohio, Virginia, West Virginia and Wisconsin. The schedule covers the annual

reports for the year ended December, 1937, December, 1938, October, 1939 and October, 1940. Your file also indicates [fol. 1960] that Missouri received a report as of the year ending December, 1936, and Wisconsin received reports of the years ending December, 1935, and December, 1936.

A. Yes, sir.

Mr. Jaegerman: I now offer this file and this schedule in evidence as Exhibit 79.

Exhibit 79

The papers referred to were in evidence, marked as above indicated, and the same are attached hereto as a part hereof.

Q. Have you brought with you the annual reports for the year ending December, 1937, December, 1938 and December, 1939?

A. Yes, sir. December 31, 1937——

Mr. Jaegerman: I offer the audit report of Fidelity Investment Association and subsidiaries of December 31, 1937, by Wilson and Cross, as Exhibit No. 80.

Mr. Lauritzen: Mr. Jaegerman, may I ask whether it is offered for the purpose of showing that is the report he referred to in his testimony showing what states got the various reports?

[fol. 1961] Mr. Jaegerman: That is right, and as copy of the report that was actually furnished these states.

Mr. Lauritzen: It is not offered to prove anything that is therein contained?

Mr. Jaegerman: It is not offered to prove the contents of the report, merely to show that the report was furnished and what is in the report was therefore notice to the various states. It is not offered as true or untrue.

Exhibit 80

The paper referred to was admitted in evidence, marked as above indicated, and the same is attached hereto as a part hereof.

Mr. Jaegerman: I offer in evidence the Wilson and Meredith annual audit of Fidelity Investment Association and its subsidiaries as of December 31, 1938.

Exhibit 81

The paper referred to was admitted in evidence, marked as above indicated, and the same is attached hereto as a part hereof.

Mr. Jaegerman: I offer in evidence as Exhibit 82 the an-
[fol. 1962] nual audit of Fidelity Investment Association and its subsidiaries as of October 31, 1939, as prepared by Haskins and Sells, Certified Public Accountants.

Exhibit 82

The paper referred to was admitted in evidence, marked as above indicated, and the same is attached hereto as a part hereof.

Q. Mr. McNulty, was the fiscal year of the Fidelity Investment Association changed in 1939?

A. In the early part of 1939 it was changed to end October 31, of each year thereafter. That period covered a ten months period.

Cross-examination.

Mr. Huwe: Your Honor, the other day we were inquiring into the interpretation of the law with reference to whether the company had to deposit only contracts that were sold or contracts that were owned by people who resided in those states. I find under date of October 20, 1938, a letter, Exhibit 74, some reference to that particular question, and I would like to present that to Mr. McNulty and ask him to examine it and then state whether or not thereafter or [fol. 1963] prior thereto they followed any particular procedure in that respect.

A. Well, in all our reports, when a contract holder changes from one state to another, it was automatically changed on our records, and the state where the contract holder resided at the time the report was made would be included for that particular state.

Q. That was the practice of the company, then, under the law, regardless of your obligation under the law?

A. Well, it was assumed—some states specified that the liability shall cover contracts held by residents of that state, and others, I believe, say sold and issued and held.

Q. It would take an examination of all the state laws to determine that question correctly?

A. That is right, sir, and for uniformity we adopted a policy of reporting a liability on residents of the state at the time the reports were made.

Q. Would there be many states in which there was a considerable number of contract holders who did not buy their [fol. 1964] contracts originally in this state but who now own the contracts and reside in those states?

A. Well, if you take, say, two specific states, I would say no, but if you are talking about moving out of one state there might be fifteen or twenty move throughout the United States, but as to a change from one particular state to another particular state, I don't think the change would amount to very much.

Q. Then if all that was required under the law in some of those states was that the company only deposit securities that were in funds that were sold in those states, and the debtor decided to withdraw the securities over and above those that were sold only in those states, would there be much withdrawal or would it be a very small figure?

A. Well, I couldn't answer that. I would have to check that.

Q. You wouldn't be able to answer it?

A. It wouldn't be a substantial figure, but it would have to be checked.

Cross-examination.

By Mr. Palmer:

[fols. 1965-1966] Q. Do I understand the present list of contract holders submitted by the trustee, together with the assets, is based upon the states in which they live as shown by the books of the company?

A. I didn't prepare that statement. I couldn't answer that.

Q. Who did prepare that?

A. It was prepared under the direction of Mr. Smith.

Q. Mr. C. E. Smith?

A. No, Isaiah Smith.

Q. That has been the practice, however, to keep the names of the contract holders according to their residence, where they live?

A. Yes.

Q. Not where the contract was sold.

A. That is right.

. . . . . .

[fol. 1967] Q. Mr. McNulty, Exhibit 78, the folder of Wisconsin reports, apparently the earliest one you have here is July 31, 1935.

A. Yes.

Q. What does that mean as to whether there were any reports made earlier than that year?

A. Well, I didn't check back beyond '35, but certainly I think that there were at least interim reports filed.

Q. These reports in '35 appear to be semi-annual reports, do they not?

A. I just took two copies from each year's reports, and there was a report filed, I am sure, from July up through December of that year.

Q. That is for a half year period?

[fol. 1968] A. No, each month.

Q. I would like to have you be quite positive on that.

A. Well, I say that is my understanding of it.

Q. My records indicate that you commenced to make monthly reports only in 1939, and that previous to that time you had made reports either annually or semi-annually.

A. No, I am sure—(examining exhibit) I say that there were monthly reports filed during the year 1936. Here is two sample copies; one is as of September 30, 1936; one is as of January 31, 1936. That is no semi-annual period, and I am positive that there were monthly reports filed in between them.

Q. None of those reports purported to show the liability by funds, did they?

A. No.

Q. I think that is satisfactory, then, Mr. McNulty.

A. Yes, sir.

Q. Now, Mr. McNulty, I would like to have you identify these booklets here for me, if you can——

Mr. Jaegerman: May I interrupt?

[fol. 1969-1970] Mr. Lauritzen: Yes.

Mr. Jaegerman: You didn't mean that none of the monthly reports ever furnished Wisconsin showed the breakdown by months and by series? You mean 1935 and 1936?

Mr. Lauritzen: No, I did not. Let me try to clear that up.

Q. Do you know when it was that you ever informed Wisconsin of a series breakdown of liabilities?

A. You mean on our monthly reports?

Q. Yes.

A. I think the first monthly reports filed which showed the breakdown was June or July, 1940. That is my recollection of the file.

Q. And before that time you made no such segregation in your liability report?

A. Not to Wisconsin on the monthly reports, no.

Q. And did you on some annual report?

A. On our annual audit report the segregation of funds was shown.

* * * * * * *

[fol. 1971] Mr. Lauritzen: Mr. McNulty, showing you what has been marked for identification Exhibit 83, which appears to be a pamphlet in the nature of a prospectus relating to Series D contracts, can you identify that for us?

A. That is a descriptive booklet used by our sales organization.

Q. When was that booklet issued?

[fol. 1972] A. Well, 1939. I don't know the exact date.

Q. This Exhibit 83 was issued after the SEC injunction?

A. That is right, yes, sir.

Q. I now show you what has been marked Exhibit 84, apparently a similar pamphlet relating to Series B contracts. Was that issued at the same time and for the same purpose?

A. Yes.

Q. These two booklets, Exhibits 83 and 84, were in use for how long a time, Mr. McNulty?

A. Well, there were booklets issued at a later date than those, but a descriptive booklet was used up to December 31, 1940.

Q. I mean these particular gray ones, that is, Exhibits 83 and 84—you used that for just a short time during 1939? Am I right in that?

A. I would say yes, up until the figures of the next period were prepared, yes, sir.

Q. And do you know how long that would be?

A. No, I don't know how long that would be.

Exhibits 85, 86 and 87

[fol. 1973] Three booklets, at the request of Mr. Lauritzen, were marked for identification as above indicated.

The Court: How much more of this is there going to be, Mr. Lauritzen? We can't go on very much longer.

Mr. Lauritzen: I don't think it will be very long, Your Honor, but I will say we deem it of the highest importance.

Mr. Farmer: It is very important.

The Court: Is there any other examination of this witness after Mr. Lauritzen gets through?

Mr. Farmer: I think not.

Mr. Lauritzen:

Q. Mr. McNulty, let me show you some other pamphlets that have been marked Exhibits 85, 86 and 87, one being a descriptive booklet relating to Series B income reserve contracts, another being a descriptive booklet relating income reserve contract Series B, apparently a somewhat different color, and another one being a descriptive booklet relating to income reserve contract Series D. Can you identify those for me and tell me when they were issued and went into use?

A. As to the date they went in use, I couldn't tell you, [fol. 1974] but they were used sometime after, I would say, November or December, 1939.

Q. Now, comparing those last three booklets with these first two, we note that the last three contain considerably more information than the first two. Is that not correct?

A. I couldn't answer that without looking them over.

The Court: The books will show for themselves, if they are in.

Mr. Lauritzen: Yes, sir.

Q. Can you tell me, Mr. McNulty, whether, when these gray booklets were issued and went into use after the SEC injunction, there was any discussion had between the officers of Fidelity and the SEC relative to the propriety of this book being used under the terms of the injunction?

A. I couldn't answer that. I didn't have any discussion with them.

Q. Who prepared these gray booklets, Exhibits 83 and 84?

A. In what manner do you mean?

[fol. 1975] Q. Who got up the data in them?

A. Well, the financial figures were taken from the audit reports.

Q. By what person in your organization?

A. Well, I imagine the statistician at that time.

Q. Who was that?

A. He was Mr. Gass, that is my recollection of it now. I didn't.

Q. Looking at these next three booklets, can you tell me who got up the information in those and prepared and compiled those booklets?

A. The financial information was taken from the audit reports.

Q. But what person did it?

A. I can't say definitely. I don't know.

Q. Who would be the person that had charge of that particular matter?

A. Well, I think that these sheets in this report are taken from the same printing plate that was used by Haskins and Sells. I think it is nothing but a reproduction of the Haskins and Sells report. There wasn't any necessity of [fol. 1976] compiling the figures. Those figures are identical with Haskins and Sells'.

Q. But this other material in here, the narrative description of the contracts and the various sales talks, that is not from the Haskins and Sells report, is it?

A. No, I would say that was prepared by the sales promotion department.

Q. Who would that person be?

A. I think it was Mr. O'Brien.

Q. Do you know whether these three booklets, Exhibits 85, 86 and 87 were exhibited to officials of the Securities and Exchange Commission in order to determine whether they were proper for use in view of the consent decree that had been entered in Detroit?

A. I couldn't say definitely, no; I don't know.

Q. Who could tell me the facts in that regard?

A. The legal end would take care of that.

Q. Just who would that be at that time?

Mr. Ray: What difference would it make, Your Honor?

Mr. Farmer: It makes this difference, if the Court please. In those descriptive booklets that they issued [fols. 1977-1978] and that one of the witnesses said they

used to send out to their contract holders and made them sign receipts saying they got it before they took the contract, it told them there that the states had these deposits; and there are figures shown there by funds which would not necessarily control because of the fact that some of the states had these deposits. Now, we want to show that that was to go out to the public, the contract holders, and that the SEC concurred in those representations.

Mr. Reinhardt: Your Honor, I move that be stricken.

The Court: It doesn't make a bit of difference, as far as I can see, who compiled it. They say it was put out to purchasers——

Mr. Farmer: It amounts to this: they are telling the public one thing and if they are coming here today insisting on some other theory, the trust fund theory that Mr. Jaegerman evolved up there in Detroit for the first time, that is contrary to the representations to the public.

The Court: The particular question is, who prepared [fol. 1979] this?

Mr, Farmer: We want to get at this: we want to prove it was taken up with the SEC and all these booklets were shown to them and worked on.

The Court: That wouldn't have any bearing on it; who prepared it.

Mr. Farmer: That man would know about it. We are trying to find the man.

The Court: If you know, or think you know, it was taken up with the SEC, I think you would know who did it.

Mr. Farmer: That is what I am trying to find out.

The Court: Then you have no basis for saying it was taken up.

Mr. Farmer: I saw Mr. McNulty out in the hall the other day, and I think I quote Mr. McNulty, that he felt sure it was; that you all wouldn't have put it out without having assurance that it met with their approval.

The Court: Let him be asked that on the witness stand.

Mr. Farmer: That is what we are asking him.

[fol. 1980] The Court: There is no such question as that asked him yet.

Mr. Lauritzen:

Q. Mr. McNulty, after the trouble with the SEC and the injunction decree, one of the things the company had to be very careful about was to make a full disclosure to all

contract holders in order that the injunction decree would not be violated.

A. We were advised that that would be the proper procedure.

Q. You prepared these booklets to meet that situation, didn't you?

A. Yes.

The Court: Let me ask you this, Mr. McNulty. Do you know anything about the Securities and Exchange Commission having been shown this booklet that Mr. Lauritzen has in his hand and having signified its approval of it?

A. No, sir.

The Court: Then why ask him all these other questions? That is the point you were trying to get at.

Mr. Lauritzen: This Exhibit 86, for instance, relates to the balance sheet for Series B income reserve contract, and [fol. 1981] it contains a lot of footnotes to those balance sheets, and I would like to read you footnote No. 4. Up here in the balance sheet they show "Reserve Fund Deposited with State Authorities" as the last item on the asset side. Footnote 4 says, "The securities deposited with state authorities are subject to the requirements of the states with respect to all the contract funds of Fidelity Investment Association and are not necessarily held for the sole benefit of the holders of these particular contracts. In this connection reference is made to the foreword in this report." Now, according to your information, was the purpose of the company in issuing this booklet to give notice to any purchaser of a Series B contract that the securities shown on the asset side of the balance sheet in here might be subjected to liability for some other series in some one of the states under the laws of the states?

The Court: It doesn't make any difference what the purpose was, Mr. Lauritzen. You have shown that this booklet was sent out and that it was used in connection with the sale of those contracts. Now, so far as the Court [fols. 1982-1983] can see, that is the pertinent thing that you are driving at; and as far as the purpose of the company in putting it out, that has no bearing; the Court is not going to permit any questions on that at all. If a booklet containing these statements was furnished in connection with each sale, then that is sufficient for the pur-

poses that you are trying to put in evidence, so far as the Court can see. That is all we will have time to do with this witness tonight. If anybody else wants him, he will have to stay over.

Mr. Reinhardt: I want him, Your Honor.

Mr. Lauritzen: May I offer these in evidence, Your Honor? Is there any objection to them?

Mr. T. C. Townsend: This witness will have to remain.

The Court: Yes. Yes, these booklets may be received in evidence.

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EXHIBITS 83-87, INCLUSIVE

The booklets referred to, having been heretofore marked for identification, were admitted in evidence, marked as above indicated. The same are attached hereto as a part hereof.

[fol. 1984] The Court: No.

Before we adjourn Court, the representatives of the Securities and Exchange Commission furnished certain certificates with reference to applications for exemption filed with the Commission, stating what action was taken and what the situation was with reference to them. I understand that Mr. Palmer wished to have that information go in evidence with reference to members of the Board of Directors of Fidelity, and if so, I would suggest that it be put in in some other way than by filing these certificates, [fol. 1985] because we want to lighten this record as much as possible. Can it be put in by stipulation?

Mr. Palmer: I think, Your Honor, we can probably put in, say one of them, and agree that the others are exactly the same except for the name; and, as I understand it, the Securities and Exchange Commission said that there was no action ever taken on those applications for exemptions filed.

The Court: That is what the certificate says.

Mr. Reinhardt: Whatever the certificate says is what the Commission will say.

The Court: All right. Suppose you take these, Mr. Palmer, and read into the record whatever is necessary.

Mr. Palmer: I have here, "United States of America, Securities and Exchange Commission, application for exemption filed with this Commission, February 3, 1941, by

John Marshall as director of Fidelity Assurance Association," and with the exception of the name each one of these is the same, for John Marshall, Jr., Harold Foster Pulfer, Howard Emmett Reed, Fred Smith Risley, Charles [fols. 1986-1987] Edward Smith, and Austin Andrew King; so far as being a director of Fidelity is concerned, although there might be a slight difference in wording as to other positions held by them; and we will submit the one of Mr. John Marshall as an example of all of the others with the agreement that the others are exactly the same except for the name and positions held.

Mr. Reinhardt: I have not examined any of these. I don't know whether they are exactly the same or not. If I find that there are any variations——

The Court: Change it tomorrow. That is right.

EXHIBIT 88

The paper referred to with respect to John Marshall was admitted in evidence, marked as above indicated, and is attached hereto as a part hereof.

Mr. Palmer: We are stipulating that the others are the same except for the name and character of connection.

Mr. Reinhardt: Subject to correction.

Mr. Palmer: Subject to correction.

* * * * * * *

[fol. 1988] Mr. Lauritzen:

Q. I did talk to you, Mr. McNulty, after you left the stand yesterday with respect to the Wisconsin reports, and I believe the summary of your testimony was that it wasn't until July or August, 1940, that you informed the State of Wisconsin by monthly reports of the liabilities in Wisconsin by series.

A. Yes, it was in July, 1940 that I first——

Q. But you made the comment before that time that you thought Wisconsin had been so informed by virtue of the company's annual reports that you had from time to time sent out to Wisconsin.

A. Yes, sir.

Q. In that connection, it is a fact, isn't it, that those [fol. 1989] annual reports didn't show liabilities by states or by funds in states, but merely showed balance sheets of the various funds in all states?

A. No, I think that audit report for the the last—well, since 1936, I think would have some reference to the liability by states.

Q. It wouldn't have any reference to the liability by funds by states, would it?

A. I am not sure, but I don't think it was broken down in that manner.

Q. I would like for you to be quite positive on that, if you please, Mr. McNulty. I understood from what you told me off the stand it wasn't brokendown in that way.

A. Well, I said I didn't believe it was.

Q. Did you refer to such reports as the Haskins and Sells audits?

A. In this question here?

Q. Yes.

A. Am I referring to Haskins and Sells?

Q. Yes.

A. Yes, or to the audit report made by the firm be-
[fol. 1990] fore——

Q. (Interrupting) I don't suppose they are broken down by fund in the various states in any of those reports, are they—the liabilities?

A. I am not positive on that.

Q. Could I ask you to check that some time today, Mr. McNulty, when you get off the stand, and then let me know about that?

A. Yes, sir.

Mr. Lauritzen: Thank you.

Cross examination.

By Mr. Jaegerman:

Q. Mr. McNulty, these annual audit reports that have been introduced in evidence yesterday from 1937 to date do show segregation by series, do they not?

A. Yes, sir.

Q. And by funds within those series?

A. Yes, sir.

Mr. Jaegerman: That is all.

Cross-examination.

By Mr. Farmer:

Q. You mean by showing segregation by series that in
[fol. 1991] some of the reports in showing the liabilities in

the states you list special income so much, and special annuity so much, Series A, Series B and so forth, so much, and then show the total, but you don't mean that you broke down and said these assets over here were for special income and these for special annuity and these for Series A—you didn't do that in the Tennessee reports, did you?

A. We were talking about the audit reports.

Q. I thought you were talking about the reports to the state.

A. No, this is the audit report.

Q. Oh! you are talking about the audit report? Is that it?

A. Yes.

Q. And not the certificates that you sent to these state officials?

A. Well, the certificates were also broken down by fund?.

Q. That is what I said, in the liabilities, but not a corresponding breakdown by deposit of securities.

A. Well, in some states it was filed that way.

[fols. 1992-1998] Q. Yes, but you don't mean that was the general practice, and you have outlined the special instances where that was done?

A. Yes.

* * * * * * * *

[fols. 1999-2007] J. H. SCHELLHASE recalled, testified as follows:

* * * * * * * *

[fol. 2008] Cross-examination.

By Mr. Jaegerman:

Q. Before we proceed with our analysis of Series B, I would like to clear up one matter for the record, Mr. Schellhase. There was some testimony several days ago that in February, 1941, certain securities were withdrawn [fol. 2009] by the association from deposit in Charleston and several days later other securities were redeposited. Are you familiar with that?

A. That is correct.

Q. Are you familiar with the fact that there was about a $1,100,000 deficiency in the redeposit?

A. In the book value.

Q. Can you explain how that came about?

A. In rough figures the difference in book value was the agency note of $750,000 which the Central Trust Company

held in Cleveland, and also real estate notes on the several pieces of real estate we have had testimony on before, in the amount of about $423,000; so in all it would give you your $1,100,000, the difference between the book value of around $4,000,000 and that $2,900,000 that was put back into West Virginia.

Q. So that explains the apparent discrepancy?

A. Yes, sir.

The Court: And the note of $750,000 was worthless in the first place?

A. We considered it worthless.

[fol. 2010] Q. And the real estate was held as real estate on the books of the debtor, and since there were no securities representing it they couldn't be sent back?

A. No.

The Court: All right.

Mr. Jaegerman:

Q. What were the dates of that withdrawal and redeposit, if you know, Mr. Schellhase?

A. The withdrawal on February 11th and redeposit I think February 15th.

Q. Did the association recognize the worthlessness of these National Sales Agency, Inc., notes and set up a reserve against them?

A. Yes, they did.

Q. What was the amount of the reserve?

A. $750,000.

Q. What was the amount of the notes?

A. $750,000.

Q. About what date did the association set up this $750,000 reserve against the $750,000 National Sales Agency, Inc., notes?

A. I think it was December 31, 1940.

Q. We have been discussing the insurance feature of the [fol. 2011] Series B contract, Mr. Schellhase.

A. Yes, sir.

Q. And you have testified that fifty cents a month for the first sixty months was deducted as insurance cost and twenty-five cents a month for the second sixty months.

A. That is true.

Q. Please explain how those deductions were computed.

A. The amount of fifty cents and twenty-five cents was

computed so that it would make the bookkeeping simple in this way, that under Section 7, without insurance, additional credits were allowed on the contracts in the amount of fifty cents, so to make bookkeeping simple, whether a contract had insurance or didn't have insurance, we made the insurance deduction the same amount as the additional credits, although on actuarial tables set up by Fackler and Briby they showed the exact amount, or the estimated amount of the cost of the insurance. In other words, at the first payment on a contract, we would have to procure insurance for $676, and basing that on a dollar a thousand, [fol. 2012] we would have to pay 67.6 cents for that insurance at that time, although we only deduct fifty cents from the payments, as I say, to make the bookkeeping simpler and easy on our tabulating cards, so that the fifty cents a month deduction is not enough at the beginning of the contract and over a certain period of months to take care of that insurance—or the cost of that insurance.

Now, as I stated to the Court the other day—I would like to make myself clear—we paid the insurance company the full amount of the premium. Then, in turn, at the end of the year—or it was the practice of the insurance company, I think, during 1940, to give back to us some amount based upon the mortality figures that they had and a certain percentage that they took out for expenses and things—an amount of money back, so that as far as the deduction of fifty cents for insurance is concerned from the payments, it is not enough to take care of the insurance, but when the amounts that came back from the insurance company were taken into consideration it was then enough to pay for the cost of insurance, and I think we made [fol. 2013] a little profit, as I said the other day, on that.

Q. The Series B insurance feature was an additional source of profit to Fidelity Investment Association?

A. Small.

Q. Small or large, it was a source of profit?

A. Yes.

Q. It was a profit which was shared in by both the association and by the insurance company?

A. That is correct.

Q. Was this sharing agreement oral or written between the association and the insurance company?

A. I do not know. I can't tell you that.

Q. What was the insurance company?

A. Lincoln National Life Insurance Company of Fort Wayne, Indiana.

Q. Approximately how many Series B contracts are in effect today?

A. Approximately forty-nine thousand.

The Court: Let me ask this. Was the Series B the only contract sold after you started, or were there other con-
[fol. 2014] tracts also continued to be sold?

A. No, they stopped selling the Series A contract when the Series B contract came into existence.

Q. For how many years has the Series B contract been the only contract sold?

A. Your Honor, the Series B contract has not been the only contract sold. The Series D, which does not have insurance, and does not have an insurance feature, came into existence in 1935, and both the Series B and the Series D contracts were sold at the same time. I think the Series D was made mostly for Ohio.

Q. They are alike except for the insurance feature in the Series D?

A. No, not right exactly.

Mr. Jaegerman:

Q. There are some slight variations in the reserve improvement rate?

A. Yes, sir.

Q. Concerning the sale of Series A or Series B contracts in 1934, Series B was first offered on June 15th, 1934, according to your testimony yesterday. Is that right?

A. That is correct.

[fol. 2015] Q. For several months, due to the natural lag in having it qualified in the various states, were not the Series A contracts also issued and sold by the association in those states where B had not been immediately qualified?

A. I would say I think so. I am not sure about that, because I am not familiar with that.

Q. But that would only occur for a few months?

A. Yes, sir.

Q. Until Series B were qualified in all states?

A. That is correct.

Q. Where the association intended to do business?

A. Yes.

Q. What different categories of Series B contracts are there now?

A. There are six. The current contracts, on which contract holders have made payments within a year.

Q. What percentage of the presently existing Series B contracts are current contracts?

A. I would say about 42% at April 10, 1941.

Q. What others?

A. There are delinquent non-improving contracts; there [fol. 2016] are delinquent on a paid-up basis contracts; there are paid in full contracts; there are paid up contracts, and there are maturity and retirement contracts.

Q. What percentage of the Series B contracts were delinquent as of April 10, 1941?

A. About 47%.

Q. Pardon?

A. About 47% were delinquent non-improving contracts.

Q. So that the active and the delinquent non-improving comprised almost all of the Series B contracts?

A. Yes, sir.

The Court: What about the delinquent non-improving? Explain that a little further. What does that mean?

A. Those are contracts, Your Honor, that have less than twelve payments made on them. If a contract has less than twelve payments, there is no cash surrender liability. At the twelfth month the surrender value is $25.00; but before that time the contract has no surrender liability, although it does have a reserve liability from the ninth [fol. 2017] to the eleventh payment—created out of payments from the ninth to the eleventh payment. So we put those into a class by themselves, for the reason that since there is no cash surrender liability there is no need for improving those amounts of reserve. I might explain the delinquent on a paid up basis. After a contract has reached twelve months and has a cash surrender liability and a reserve liability, that is put into a separate category, for the reason that at the twelfth payment a paid up contract can be had, and those paid up contracts, there is no more money paid in on them, and the reserve on those contracts is improved, so that annually a larger amount of return is available to improvement.

Q. Those that have been paid on for longer than twelve months and then become delinquent are changed into paid up contracts for small amounts? Is that right?

A. It depends upon the amount of payments made on them.

Q. Well, I mean, for example, if you have a thousand or twelve hundred dollar contract which paid for a year, then during that year there are no cash surrender values, [fol. 2018] but as soon as the thirteenth payment is made it begins to have a cash surrender value? Is that correct?

A. At the end of the twelfth payment, Your Honor.

Q. As soon as the twelfth payment is made.

A. At the end of the twelfth payment.

Q. And it also, if it becomes delinquent at that time, has a value in providing a paid up contract.

A. That is correct.

Q. But that paid up contract would be a very small one?

A. Oh, yes.

Q. What would it be as the result of, say twelve payments? The first time that it had any value at all what would that value be on the basis of a $1200 contract?

A. I am not just certain of——

Mr. Jaegerman: Your testimony yesterday was $25.00.

A. That is the cash surrender value.

Q. It would be approximately the same, would it not? It would be future value of $25.00?

[fol. 2019] A. That is about correct.

Q. That all appears in the schedules in the contract, doesn't it?

A. Yes.

Q. And it is strictly a future value of that cash surrender value at the end of the future period, which in the Series D contract was 126 months, was it not?

A. That is correct.

The Court: That explains that feature. You testified a while ago that there would be during the current year about $800,000 of liabilities by reason of improvements if those improvements were made. You didn't figure anything for this 47% of Series B contracts that have no cash value, did you?

A. No, I was just giving an estimate, Your Honor I was figuring on reserves, not on cash values. You see, the cash values are only improved by the reserve being improved.

Q. But you didn't calculate that there would be any necessity for making any improvements to this 47% of Series B?

[fol. 2020] A. No.

The Court: All right.

Mr. Jaegerman: Mr. Schellhase, you have been talking about a contract being less than twelve months old or more than twelve months old. You don't mean from the date that contract was issued, do you, necessarily?

A. No, no. I meant twelve payments or less. It may be two or three or four years old. It has to be when it gets into the non-improving class more than a year old—I mean a year delinquent—so it could be two or three or four years delinquent at this time.

Q. So the forty-some odd per cent of contracts that you said were delinquent non-improving had less than twelve monthly payments made on the contracts.

A. That is correct.

Q. Although the contracts may have been issued as early as 1936?

A. That is correct.

Q. There are forty-odd per cent of contracts that you said were current or active. Some of those contracts may have less than twelve monthly payments made and some [fols. 2021-2033] more than twelve monthly payments made.

A. That is correct.

. . . . . .

[fol. 2034] The Court: Since they started selling the Series B, is what I am inquiring about. The purpose, of course, is to try to determine whether there is any prospect for continued business of that kind in the future. As I understand, the present requirements are that you shall not agree to improve this reserve at a higher rate than 3½%. Is that correct?

Mr. Jaegerman: Under the terms of the Investment Companies Act of 1940.

The Court: And now, from your experience with the company during the last stages, would it be possible to do that from return received from investments such as the company now has?

A. Improved at 3½?

[fol. 2035] Q. Three and one-half.

A. I doubt whether it would be possible to improve it at 3½, Your Honor. I would say something around between 2 and 3%.

Q. How do you arrive at that?

A. Of course, one reason is that we would have to conform to the—under the Investment Company Act we would have to conform to the laws of Washington, D. C., in regards to investments—the buying of investments.

Q. Mr. Young stated that that would be slightly more liberal than the portfolio the company now has. Is that your understanding?

A. Of course, I don't know about that, Your Honor.

Mr. Palmer: Your Honor, may I suggest this? I think what Mr. Schellhase has in mind—I may be mistaken—is that under the Investment Company Act of 1940 there has to be a sufficient reserve of securities deposited to improve at that rate, and it would require an additional deposit of securities in order to improve at this lower rate. Is that right, Mr. Schellhase?

[fol. 2036] Mr. Jaegerman: Before you ask that I think I ought to point out that the act only applies to new business, not to old business.

Mr. Farmer: We disagree with that construction, if the Court please.

Mr. Lauritzen: Doesn't it say here that "said company shall maintain at all times minimum sufficient reserves on all outstanding face amount certificates"? That means all, doesn't it?

Mr. Jaegerman: The interpretation has been that the old companies may remain in business without improving their reserves by that amount. That is by rule and regulation.

Mr. Farmer: Is that by rule and regulation of the Securities Commission?

Mr. Jaegerman: I don't know.

The Court: There is one feature about that the Court doesn't yet understand. The old Series B contracts provided for improvement in reserve at the rate of 4½%. It seems to the Court that that improvement at the rate of 4½% would require a higher yield on securities held by the company than would improvement at the rate of 3½%. [fols. 2037-2041] and that it would take a greater amount

of securities to provide the 4½% than it would the 3½% yield. Is that right or wrong?

Mr. Jaegerman: It would depend on what the securities are yielding. You need more securities at the same yield to give you 3½ than to give you 4½. If your securities are yielding 4½% you would need, say $100,000 at that rate, but you need less than $100,000 of securities at the same yield to give you 3½% of that amount.

Mr. Reinhardt: I think, if the Court please, that we could discuss this off the record.

The Court: Yes.

(There was a discussion off the record.)

The Court: Just put on the record that the Court now understands the fact to be that the lower the required rate in connection with the building of reserve, the larger the amount of securities that would be required to produce the required return at the end of the period. Is that right?

Mr. Reinhardt: Yes.

* * * * * * *

[fol. 2042] Q. Who got that difference between the cash surrender value and the active reserve that had been set up against that contract?

A. The Fidelity general fund during 1940.

Q. And that would be a part of the funds or the amounts that would be available in answer to His Honor's questions as to how the difference between the required improvement rate and the basic amount realized on investments was concerned?

A. That is right.

Q. So that the profit on cash surrenders was transferred to the general fund, and, in turn, used by the association to make up any deficiencies in earnings of the various funds?

A. Yes, it would be.

Mr. Palmer: May I ask one other question, for my enlightenment, Your Honor, at this time? If the profit were from the fund, why wasn't it left in the fund instead of being transferred back to this general or so-called stockholders' fund.

A. It was my instructions from the president, Mr. Risley, to transfer the gains on surrenders from the contract fund

[fol. 2043] to the general fund. I know nothing about what he based his opinion on or anything about it.

Mr. Jaegerman: Don't you know that was based upon legal opinion or legal work done by Koontz and Koontz for Mr. Risley?

A. I understood it was like that, but I have no proof of it.

Q. And that a friendly suit was brought in a state court in Kanawha County to be the basis for such a legal opinion by the firm of Koontz and Koontz?

A. That is what I heard.

Mr. Palmer: Then it was legally done, and your answer is that it was done by virtue of a decision of the Circuit Court of Kanawha County?

A. I have never seen that decision.

Q. That is the answer that you are giving to Mr. Jaegerman.

A. I said I heard that.

Mr. Palmer: Then it either ought to go into the record, Your Honor, as such, or be stricken. Either it is based upon a legal determination by a court or it is hearsay. The [fol. 2044] witness hasn't said anything about a friendly suit. Suits aren't friendly, and I think the Circuit Court of Kanawha County is above those remarks.

Mr. Jaegerman: Maybe he didn't have information about it.

Mr. Farmer: I object to the colloquy between counsel.

The Court: Go ahead.

Mr. Palmer: If Your Honor please, I move that the remarks of counsel as to it being a friendly suit, or any implication than any legal determination was other than honest and correct, in this county, be stricken from the record.

The Court: Well, the Court is aware that there are many such proceedings as that brought for the purpose of determining a legal point. I don't think there was any implication of impropriety in the counsel's question, so I overrule the objection.

Mr. Jaegerman:

Q. Mr. Schellhase, please explain how and why transfers were made from the Series B active fund to the Series B maturity and retirement fund.

[fol. 2045] A. The maturity and retirement fund is set up for the paying out of maturity values after the contract holder has completed his payments. At the time the contract holder has completed his payments the amount of reserve is taken from the active reserve fund in cash and transferred to the maturity and retirement reserve fund. From thence the commuted value or maturity value and optional settlements are paid; and that reserve is improved at the same rate of interest, 4½ compounded semi-annually.

Q. If that fund should earn more than 4½% compounded semi-annually, who would be entitled to the excess earnings?

A. The general fund of the association.

Q. If the active fund should earn more than 4½% compounded semi-annually, who would be entitled to the surplus earnings?

A. The excess earnings goes into the surplus of the fund, but the surplus of the fund is divided between 50% to the contract holders and 50% to the Fidelity general fund, based upon the valuation of securities at whichever is lower, cost or market.

[fol. 2046] Mr. Lauritzen: Mr. Jaegerman, excuse me. Don't your questions lose sight of the fact that you have got to maintain these state deposits up to their proper ratio at all times? Correct me if I am wrong. Or does that question assume that before anything went into the general fund, regardless of this arbitrary reserve improvement rate, that you would have to maintain your state deposits.

Mr. Jaegerman: I don't believe my questions have anything to do with the state deposit requirements or the maintenance of them.

The Court: It is true, however, as an observation on Mr. Lauritzen's question, is it not, that the cash values at all times were less than the reserve?

Mr. Jaegerman: Required reserve, yes, Your Honor.

The Court: And therefore, when the state deposits were maintained on a basis of covering all cash value liabilities, they would certainly be less than the reserve, and would not need to be as much as the reserve.

Mr. Jaegerman: That is right, but in a state like Wisconsin, where they might require 110%, it would be a mat-

[fols. 2047-2059] ter of mathematical calculation whether the reserve were or were not 110% of the cash surrender

value. Another complicating factor is that a state agency might use one method of calculating the market and the association might use another method. Furthermore, in many states the qualifying deposit should have come, in my opinion, from the association's general or stockholders' fund, and not from any contract fund.

Q. Do you have figures with you showing approximately what the present market value of Series B active fund securities is?

A. They are considerably more than book value. The balance sheets would show that.

* * * * * * *

[fol. 2060] Mr. Palmer: My question is based on this. I wanted to know from Mr. Young where he got the amount that was necessary to be deposited in each state. He said you prepared certain figures, at certain intervals, showing the liability of the company to those contract holders, both [fol. 2061] cash surrender, as you stated, and reserve liability, and sent it to him. Is that correct?

A. That is correct. That is every six months.

Q. Then there wasn't any other monthly one sent to him by you for that purpose?

A. Not by me, no.

Q. The next question I have is, from time to time in these states contracts were sold creating, after certain payments were made, new liabilities, both in cash surrender and reserve. Is that correct?

A. That is correct.

Q. How soon would you get those figures after a liability, both cash surrender and reserve liability, was created?

A. Is that the question?

Q. Yes, how soon would you get those figures?

A. Of course, if it was sold in between the six months report, the semi-annual report, it would come into the next semi-annual report.

Q. In other words, you would make your basis of report the six months period which had elapsed from the previous report? Is that correct?

[fol. 2062] A. That is the one that was sent to Mr. Young.

Q. So that during that interim Mr. Young had no figures as to the liability, either cash surrender or reserve, of the company to the contract holders? Is that correct?

A. Not unless he received copies of the monthly reports that were required by certain states. If he did that, then he received them oftener than six months.

Q. During that six months period, there were every day new liabilities created to the contract holders? Isn't that true?

A. That is correct.

Q. And as a practical matter, a six months report was all that you could practically submit? Isn't that correct?

A. That is correct.

Mr. Reinhardt: The testimony is to the contrary.

Mr. Palmer: The witness says yes.

Mr. Reinhardt: He has contradicted himself.

Mr. Palmer: I don't think it is the proper time to call attention to it.

Mr. Reinhardt: I do.

[fol. 2063] The Witness: When I am referring to possibility, I mean all states.

Mr. Palmer:

Q. So that there was bound to be a lag or lapse where there were liabilities in all of the states which had not been covered by deposits because of this six months period. Isn't that true?

A. Yes, except in those states where we reported monthly.

Q. Can you state any of those states by name?

A. If I do I may leave out one or two.

Q. Well, as best you can.

A. Alabama, Illinois, Iowa, Missouri and Wisconsin.

Q. Even with a thirty day report, with new liabilities coming in daily, there was bound to be a lag whereby the liabilities would be greater than the deposit because of the impracticability of submitting daily reports of that? Isn't that true.

A. I would say a small lag. There wouldn't be much. It would depend upon the cash surrenders too and the payments received in any one state.

Q. Of course, if securities went up in any particular fund, that would cover that fund as to the liabilities? Isn't that [fol. 2064] true?

A. If securities went up in any particular fund, it would be just that much more market value.

Q. And if securities went down, on the contrary, there would be that much greater liability not covered by deposit? Isn't that true?

A. Of course, it would depend on how much of a deposit you had up in that state.

Q. What I am trying to get at is this. If a state law requires a hundred per cent deposit for liabilities, it would be impossible, as a practical matter, to keep that up from day to day with regard both to a fluctuating securities market and new creation of liabilities by virtue of sales? Isn't that correct?

A. That is correct, unless you have—your market value was considerably higher than your liability.

Q. Unless you kept a sufficient amount of securities larger than your normal hundred per cent to take up any such lag or lapses—isn't that true?

A. Yes.

Q. And for all of the states you worked that out on a six months basis.

[fols. 2065-2072] A. That is correct.

Q. And West Virginia was included in that six months basis of reports.

A. That is right.

. . . . . .

[fol. 2073] Q. Now, Mr. Schellhase, you were telling Mr. Jaegerman that on cash surrendered policies, I believe it was speaking with reference to Series B, the profit made thereby was taken from that Series B fund and put into the general fund.

[fol. 2074] A. I was speaking about the difference between the reserve liability and the cash surrender liability.

Q. Yes, and that that was taken from the fund and put into the general fund. Is that correct?

A. During 1940.

Q. Have you said that you understood that the reason you did that was because there had been a decision made by the Circuit Court of Kanawha County. Is that correct?

A. That is correct.

Q. Now, with reference to Series B, you were required to improve the reserves at 4½%. Is that correct?

A. That is correct, compounded semi-annually.

Q. And I believe it has been shown to you that the Investment Companies Act of 1940 required improvement at not to exceed 3½%. Is that correct?

A. That is correct.

Q. So that if you were to continue with that same Series B contract, you would have had to put additional securities into that Series B fund in order to meet that requirement. Isn't that true?

[fol. 2075] The Court: Are you talking about the old contract or some new contract?

Mr. Palmer: No, the old contract, Your Honor.

The Court: I think that is a question for legal determination as to whether the Act applied to old contracts.

Mr. Palmer: I agree with the Court on that, but I am asking as a matter of fact, so we can get it for the Court if the Court should so determine.

The Court: All right, depending on whether the law so applies.

Mr. Palmer: Yes. My question is, if you would attempt to comply with that law with reference to the old Series B contracts, it would be necessary, would it not, to put up additional securities in that Series B fund or cut down the face amount of the contracts, one of the two.

A. Yes, if improvement was at 3½%, naturally the face value could not be paid on the 3½% basis as on the 4½% basis.

. . . . . .

[fols. 2076-2081] Q. Would 47% be a fair estimate of the number of contract holders who brought this particular type of investment who did not carry it on for even the first year?

A. I would say that is probably right.

[fol. 2082] Mr. Palmer:

Q. Mr. Schellhase, on the insurance feature of the Series B contracts, am I correct that Fidelity had a contract or agreement with Lincoln National Life Insurance Company of Fort Wayne, Indiana, furnishing that insurance feature?

A. That was my understanding.

Q. And it is further true, is it not, that that was a group life insurance policy except as to those past a certain age?

A. It was a group life insurance policy.

Q. And only those past a certain age had to take a physical examination before they could participate? Is that right?

A. That is correct, except in a few exceptions, except

where the questionnaire might have said something that the [fol. 2083] insurance company would like to have an examination.

Q. That person had to submit a written statement to the insurance company?

A. They submitted it to us and we forwarded it to the insurance company.

Q. What was the amount paid for each person by Fidelity to the insurance company per month for that insurance?

A. Well, it was in decreasing amounts. In other words, at the first payment we had to have $676.00 worth of insurance; at the next payment up until the end of the tenth payment we had to have $676.00. After that time it decreased in proportionate amounts to the amount we needed to pay the balance of the payments.

Q. What was it you said this morning about 67 cents?

A. Basing it on a dollar a thousand in round figures we would have to pay 67 cents for the $676.00 worth of insurance for the first payment.

Q. Why did you base it on a dollar a thousand?

A. That is what it runs us, about a dollar a thousand. [fol. 2084] The premiums varied a little one way or another.

Q. I understand that you paid on this 67 cents 50 cents a month at the beginning and 25 cents a month later.

A. That is the deduction for additional credits and the amount we also deducted or put into that column on our tabulating card, so that it was more or less for accounting purposes that we only made the amount 50 cents for deduction, because the additional credit of 50 cents was taken out and set aside in one reserve, and the 50 cents we took out, we considered that as insurance premiums.

Q. Let me ask you this. What did the contract with insurance cost as compared to a contract without insurance?

A. Well, the payments were the same on both contracts, a monthly payment of $7.50.

Q. Wherein did the one with insurance cost the contract holder more?

A. In the form, as I say, of additional credits. The contract holder received back these additional credits of 50 cents a month for the first 60 months and 25 cents a month [fol. 2085] for the last 60 months that we deducted from the contract.

Q. That is, the one who didn't have insurance received this credit. Is that correct?

A. That is correct.

Q. That credit did not represent, however, the true value that the other person paid for his insurance, did it?

A. That I am unable to state, for the reason that the insurance, after a given point would be less than 50 cents a payment.

Q. You told us that the company, that is, Fidelity, made a profit on this insurance by virtue of a payment back by the insurance company to Fidelity. Is that correct?

A. That is correct.

Q. What was this payment back of the insurance company to Fidelity? What was that?

A. Well, it was in the form of cash. As I explained to the Court before, it was figured upon the mortality of the contract holders that we had with insurance, how many of them died, and of course I am not familiar with the arrange-
[fol. 2086] ments or what all it said in the arrangements on that.

Q. Where would the contract be, or who would know about that contract between the two?

A. I think that was handled by Mr. Risley, is my recollection.

Q. Isn't it a matter of fact that it was a rebate given by the insurance company to Fidelity—a rebate of premiums paid?

Mr. Ray: Why do you say it was a rebate instead of a dividend on an insurance premium?

Mr. Palmer: I am asking the witness. I don't know what it was.

A. I don't know whether it was a rebate or not on insurance premiums.

Mr. Ray: I see no reason why that policy of insurance should not be produced, if it is pertinent.

Mr. Reinhardt: It is in, Mr. Ray.

Mr. Palmer: May I see it, please?

The Court: Do you refer to the agreement between Fidelity and the insurance company as to the sharing of profits?

[fol. 2087] Mr. Palmer: Yes, Your Honor.

Mr. Reinhardt: I understood Mr. Palmer referred to the insurance policy.

Mr. Palmer:

Q. Well, was there in the insurance policy any such agreement that you know of, Mr. Schellhase?

A. Not that I know of in the insurance policy that went to the contract holder.

Q. Then, in other words, this was a separate or private agreement unknown to the contract holder whereby Fidelity made a profit on this insurance? Is that correct?

A. Fidelity in its contract stated that it would carry insurance through a legal reserve life insurance company, and I think that the contract between Fidelity and the insurance company didn't have anything to do with the contract holder insofar——

Q. Your answer, then, to my question is that the contract holder did not know about this profit being made and had no way of knowing?

A. I don't know how they would know, unless they would receive a financial statement. They may have known from [fol. 2088] that.

Q. Was there, to your knowledge, any written agreement between Lincoln Life and Fidelity as to how much this dividend, rebate or kick-back, whatever it was, amounted to?

Mr. Ray: If Your Honor please, I am going to object to all this about profit, because whose money was being spent for this insurance premium? It wasn't the contract holders'; it was Fidelity's money. Fidelity agreed to furnish certain insurance to the contract holder and the contract holder paid a certain sum of money for it; and regardless of what Fidelity did with that money it was Fidelity's money; it was not the contract holders' money, and when he talks about profit, profit to whom?

Mr. Palmer: Your Honor, let's put it this way. We are trying to see if there can be a plan of reorganization, and we are trying to see if such a plan can work. If there was a profit made to Fidelity by some secret agreement which could not be made in a new company in which this agreement would have to be publicly announced, then we have to [fol. 2089] consider that as to whether or not that amount of money could be used in a new company.

Mr. Ray: I object to the language "secret agreement." There is not a bit of evidence about a secret agreement, and I call upon Mr. Palmer to point out any evidence about a secret agreement. The only evidence is that Fidelity and

the insurance company entered into a contract for this insurance.

The Court: Mr. Palmer's question, as I understand it, simply means that that contract or arrangement was not known to the purchaser of Fidelity's contract, which the witness says he thinks is correct, and I believe the matter, although not substantial, is pertinent for whatever it amounts to, and therefore I overrule the objection.

Mr. Palmer: Do you have my last question?

(The question was read.)

A. I don't know.

Q. Who would know among the officers or employees of Fidelity as to the terms of this agreement and whether it was written or oral?

A. As I say, I think Mr. Risley, had all conferences in [fol. 2090] connection with the Lincoln Life.

Q. Would any other employee or officer of Fidelity, to your knowledge, know of that agreement?

A. Not unless Mr. McNulty would know.

The Court: How about Mr. Isaiah Smith, who now is in charge of these records? Would he know about it?

A. He may know, Your Honor.

Mr. Palmer: What was the amount of profit——

Mr. Reinhardt: Would Koontz know about it?

Mr. Palmer: I don't know.

Q. What was the amount of profit made by Fidelity by virtue of this agreement?

A. Offhand I can't answer that. I don't have the figures before me.

Q. Who would have those figures?

A. Nobody has them here that I know of, unless you would find them in the audit reports that have already been submitted, by picking them out.

Q. Weren't they put on the books of the company?

A. They are.

Q. In what fund were they put on the books of the company?

[fols. 2091-2100] A. In the general fund.

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[fol. 2101] Q. That would mean that about five-twelfths of that amount would be free and the other seven-twelfths

would be frozen into segregated funds. Now then, in "Miscellaneous Income" you have got the figure $22,547.92. How much of that was this refund from the Lincoln National Life Insurance Company on these insurance contracts?

A. In the first place, the refund—I stated that we made $13,000 a little while ago on the insurance, but that wasn't the amount on the refund on the insurance.

Q. What was the amount of the refund?

A. I do not have that.

Q. Well, that is what we couldn't get.

A. Yes.

Mr. Palmer: I thought the witness gave you that as the amount of the refund.

A. I read that to you, Mr. Palmer, the amount that was in here, amount of insurance premiums collected from the contract holders and the amount of insurance paid net.

[fol. 2102] Q. And then on top of that there was this refund, which figure you have not given? Is that right?

A. No, the insurance refund is in the amount of insurance premiums here.

Mr. Farmer: Give me the page. Do you mind me looking at it with you?

(Mr. Farmer examines paper.)

Q. Do you find it in statement 20, page 2?

A. That is correct.

Q. That shows life insurance premiums $127,298.63.

A. That is correct.

Q. Is that a part of the payments made by contract holders that were thrown into this account for life insurance premiums?

A. No, that is expense—the net expense that we incurred. That is the amount we paid to the insurance company.

Q. Is that the amount you paid the insurance company and then got $13,000 back out of that?

A. No. Here is your income statement. It says there "income."

[fols. 2103-2106] Q. That is statement 20, page 1?

A. Yes. Life insurance premiums, the amount deducted is $139,698.50. The amount delinquent is $1,411.25, making a total of $141,000 that we collected from the payments.

Q. Set aside?

A. Set aside from the payments. Then we paid to the life insurance company net $127,298.63, which is the net figure. $13,000 is the difference between the amount we received from payments and the amount we paid to the insurance company after the refund.

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[fol. 2107] Q. Well, I want to ask you about the improvements of reserve. Was the amount of the improvements to the reserves on these various contracts for the year ending October 31, 1940, approximately $1,127,000?

A. I would say approximately it was. I didn't know the exact figure when I was up here this morning, but at noon I checked that figure.

Q. At the noon hour I asked you to go over those income statements shown in that audit report of Haskins and Sells, and had added up the improvements to the various funds and showed you the figures.

A. Yes.

Q. And that figure was $1,127,732.04, and you agreed with me that that appeared to be approximately correct.

A. That is right. That is what I said.

Q. On what basis did you figure that the improvement this year would be only $800,000? How did you arrive at that figure?

[fols. 2108-2112] A. I just estimated it in my head. I didn't know the true figure of November, 1940, at the time.

Q. Wouldn't the approximate figure be about $950,000?

A. Since we are not surrendering contracts I would say it probably would run around $900,000 to $950,000 on that basis.

Mr. Reinhardt: Is that for the entire year or——

A. For the entire year.

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[fol. 2113] Mr. Farmer:

Q. Mr. Schellhase, is this allegation of the SEC's bill true, that the company intended to and did fail to segregate and apply separately cash payments received from specific classes of contract holders, comingling said cash payments, has permitted its general fund and certain contract funds to overdraw cash in very large amounts from other contract funds, said overdrafts at times totalling in

excess of $5,000,000, with and without interest allowances, and in violation of contract and statutory requirements as to investment and deposit.

Mr. Ray: Your Honor, here we have the same type of question you instructed counsel not to propound yesterday, reading from this report and saying "Is it in there?"

[fol. 2114] The Court: As I understand that, Mr. Ray, this is a little different. This is something that Mr. Farmer has found in that report which he says has never been admitted nor denied by the company, and he is undertaking now to see whether the officer of the company admits that or denies it.

Mr. Ray: Why doesn't he get an officer of the company who is charged with the responsibility of answering that, and not a statistician?

The Court: That is another question. I am not so sure of that. It depends upon what this witness says about his knowledge of that fact. Now; Mr. Reinhardt objects on the ground that, not being denied, it perforce must have been admitted; but I feel that that is not necessarily so.

Mr. Jaegerman: Your Honor, my memory is that most of those facts were specifically admitted in the answer.

The Court: I don't want to go to too much length on these matters.

Mr. Farmer: I examined it to see, Mr. Jaegerman, before [fol. 2115] I asked the question. I didn't want to take up time.

The Court: But if it will be reasonably brief—what is the answer? I will overrule the objection.

A. The contract payments as they were received by the association were taken into each contract fund and the amounts recorded on their various fund bank accounts, although in the bank there was but one fund—bank account—for the income, the annuity, the Series A and the general fund. When maturities and cash surrenders were paid from that fund, it was charged on the books of the association to the particular fund whose contract was maturing or being cash surrendered.

Mr. Farmer:

Q. And the dates of the setting up of those funds are given in your answer to my questions just previously

asked, that is, those separate funds for the different series.

A. That is correct.

Q. Is it true that the company made transfers during the years 1937 and 1938 from special annuity contract reserve fund unmatured contracts of amounts aggregating [fol. 2116] three hundred and ninety-eight thousand—If the Court please, I am going to save time; I am not going to ask that. This is in this descriptive booklet that they sent out to contract holders. I believe that is proven and it is taking up time.

The Witness: I might add one thing to my answer right above there, that the bank accounts of the income, the annuity, M and R, the A M and R were carried to the one bank account, the same as the one bank account was in the bank.

Mr. Farmer: Let me ask you this——

Mr. Ray: Your Honor, may I make a motion with respect to this line of investigation? I move that it all be stricken out because on page 252 of this document is a paragraph of the answer of Fidelity in which there is a denial of the paragraph of the bill which Mr. Farmer has been quoting from.

Mr. Farmer: I didn't see that, but it is very well that I asked the question and got the facts about it, then.

The Court: I will overrule the motion.

Mr. Farmer: Well, I have just one more question, then, [fol. 2117] Mr. Schellhase. Assuming that during this year in which you have made up the estimate for the Court——

A. Let me say something about that estimate, Mr. Farmer. That estimate was made by me—of course, it was done roughly here in Charleston, and there may be a lot of things in here like this interest on delinquent payments that I have not given any effect to in my estimate down here; so I want to say that this is an estimated figure, and there may be a few changes in these, as you tried to bring out.

Q. I realize that, and really I was just trying to improve on it a little bit, to see if we can't get a little closer to the facts about it. If, during this year, the invested assets will be about 15% under the invested assets from which the income from investments was realized for the fiscal

year ending October 31, 1940, you would have to reduce your estimate of income from investments by taking off of the figure $924,394.00 15% of that amount, wouldn't you?

A. It all depends upon what assets were reduced. If you were reducing some of the assets that wasn't paying interest or something, then it would not be.

[fol. 2118] Q. Can you tell us any other basis than just making a flat reduction of 15%? Have you analyzed the decrease in assets to see whether it should be on any other basis?

A. No, I have not.

Q. Then, since we are giving the estimate, we will just have to use that basis, I reckon, of a 15% reduction.

The Court: He says that depends on whether the 15% that you take off has been something that is producing income. I think that is clear, isn't it?

Mr. Farmer: Of course, we just have to speculate on that, then, whether it was or wasn't, and what percentage it was. I am just trying to test the accuracies of his figures.

The Court: I see.

Mr. Farmer: If he can give us any more accurate figure, I would like for him to go out and get it.

Mr. Reinhardt: It wouldn't be more than 15%, would it, Mr. Schellhase?

A. No.

Q. It might be less?

[fol. 2119] A. Yes.

Mr. Farmer:

Q. Let's assume this 15%. 15% of $924,000 is about $135,000, so if we take off $135,000 and if we take $13,000 out of your miscellaneous income, and if we take off about $30,000—let's not do that first; we might not be right in that. Let's take off the $135,000 and the $13,000. That would take $148,000 off, wouldn't it?

A. Yes.

Q. And if we take $148,000 off of your figure of $1,061,000 that brings us down to how much?

A. I can't figure it.

The Court: $913,000.

Mr. Farmer: $913,000, and if the improvements on reserve is about $950,000, how much does that leave for taxes

on the home office building, for employees and maintenance of the building? How much would that leave us to pay this interest?

A. It would leave nothing if your figures are correct.

Q. Well, can you help us out any on it?

A. Not right now.

[fol. 2120] Mr. Reinhardt: I think I can help, Mr. Farmer.

Mr. Farmer: I will be glad for you to help me.

Mr. Reinhardt:

Q. Mr. Schellhase, you gave as I recall a figure of $950,000 for the imp ovement for the year 1941. Is that correct?

A. Approximately $925,000 to $950,000.

Q. The improvement stopped when in 1941?

A. April 10th.

Q. So that the actual improvement that would be required for 1941 would be something less than 5/12ths of $950,000? Is that right?

A. Oh, yes.

Mr. Palmer: May I interrupt? I thought Mr. Schellhase, in answer to Your Honor's question this morning, said the reserve would have to be improved throughout the entire year.

The Court: I thought that too.

The Witness: No, Your Honor, I said this morning that the improvement was stopped as of April 10th, when the receivers came in, and I thought your question was if it was continued to be made—if it was allowed to.

[fol. 2121] The Court: You said it was stopped on your books, but, as a matter of fact, when you keep this money in the custody of the company, it either doesn't make any return whatever or else you have to credit it with the improvement? Isn't that right?

A. It depends on whether, Your Honor, the courts themselves decide to put that improvement on the contracts or allow it to be put on the reserve or added to the equity in each contract.

Q. I understand.

A. You were under the impression or thinking that you may allow that?

Q. That is the basis of the question I asked you.

A. But as it stands on the books now we have only improved it up to April 10th, and that would only be 5/12ths.

Mr. Palmer: Then I would have to object to Mr. Reinhardt's question; it wouldn't be applicable.

The Court: It would be applicable in the event the Court did not improve the fund. Go ahead.

Mr. Reinhardt:

Q. Can you tell us what 5/12ths of $950,000 is, Mr. Schellbase?

[fol. 2122] The Court: About $60,000.

The Witness: About 40,000.

Mr. Reinhardt: 400,000.

The Witness: 400,000.

Mr. Reinhardt: What would that leave for the payment of taxes, salaries and other expenses?

A. I would think about $524,000—something like that. If you got it down to that figure.

Mr. Reinhardt: That is all.

The Court: All right, Mr. Schellhase. You may step aside.

(Witness stands aside.)

The Court: I would like to be furnished with the newspaper clippings that have been referred to containing a purported letter of Mr. John Marshall to Mr. Herschel C. Ogden.

(Exhibit F for identification was handed to the Court.)

The Court: The Court now has in his possession the original letter to Mr. John Marshall written by Robert E. Healy, one of the Commissioners of the Securities and Exchange Commission on May 9, 1941. I will read the [fol. 2123] part of that letter that refers to the matter in controversy raised by Mr. Palmer. I quote from the letter:

"Mr. Jaegerman and other members of the Commission's staff have been constantly in touch with representatives of Fidelity, including Mr. Koontz. A few weeks ago a proposed plan of voluntary reorganization was submitted to the Commission informally by Mr. Koontz, who requested an informal expression of the Commission's views. The plan was carefully considered by the Commission, and upon such consideration the Commission indicated that

the plan was of such a character that it was very doubtful whether the Commission would be able to render a favorable report thereon under the Investment Companies Act of 1940. The Commission further indicated that it would be unable to render a favorable report on any plan which did not comply substantially with the standards of Chapter 10 of the Bankruptcy Act in relation with corporate reorganization, and further that in its judgment it was very doubtful that a plan of reorganization could practicably be effected without resort to the reorganization procedure. [fol. 2124] of Chapter 10."

I would like for Mr. Palmer to take the newspaper item and point out to the Court the conflict he said existed there between Mr. Marshall's letter and the letter from the Commission on which it is based.

Mr. Palmer: All right, Your Honor:

"I also reported to the meeting the attitude of the Securities and Exchange Commission as outlined in the communication of one of the Commissioners addressed to me, in which he stated that the Commission would not approve of reorganization for Fidelity unless it was effected by the reorganization procedure of a federal court."

That letter states definitely that the attitude of the Commission was such that there was only, as Mr. Marshall in his letter said, one thing left to do, to go into a federal court. The letter which the Court has read expresses the doubtfulness of the Commission as to whether such a procedure could be had other than in a federal court, but does not say definitely, as does this letter, that it can only be [fol. 2125] done in a federal court. I think that distinction is very vital.

The Court: Is that the only thing you had to go on in all this talk about the letter?

Mr. Palmer: Yes, sir, Your Honor, and I think this distinction is very vital in view of the fact that Mr. Marshall said he reported to the meeting in Pittsburgh that this seemed to leave no other alternative, and by unanimous action of the board an officer of Fidelity was then authorized to file suit in federal court; and I think this second statement in the letter I am reading from is not warranted by the statement which the Court has read as being the Commission's letter.

The Court: I am frank to say that I think the distinction is highly technical, and does not excuse the counsel for taking up so much space in the record and for his words in impugning Mr. Marshall's attitude and conduct in writing the letter. It seems to me that the letter of Mr. Marshall to Mr. Ogden substantially reflects what is said in the letter from Commissioner Healy to Mr. Marshall. You [fols. 2126-2148] may now return the letter to Mr. Marshall.

* * * * * * *

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Hubert F. Young, recalled, testified as follows:

* * * * * * *

[fol. 2149] Q. Mr. Young, when you received from Mr. Schellhase the figures which indicated the liability in each state as to both cash surrender value and reserve value, upon which of those figures did you make your deposit with the state?

A. Mr. Jaegerman asked me the same question. The cash values.

Q. The reserve liability was not a then due liability? Is that correct?

A. It was not a liability.

[fols. 2150-2151] Q. Beg pardon?

A. It was not a liability.

Q. What was it?

A. The cash surrender was a liability, but the reserve was built—the reserve, of course, is provided they carry the contract through to maturity. The minute they do, of course, the cash surrender and the reserve liability are one and the same.

Q. And then you increased the amount that was necessary——

A. It would automatically.

* * * * * * *

[fol. 2152] The Court: Any more questions of Mr. Young?

Mr. Palmer: I don't think so, Your Honor, I think this gives us all the information we need without reading it [fol. 2153-2159] to Mr. Young and just retranslating it.

There is one other thing, I do not believe it was brought out by Mr. Young before that one of the requirements of the Investment Companies Act was a net capital of $50,000,

and Fidelity having no capital, but being minus a million and a half, it couldn't go ahead under that Act.

A. That is the chief reason we couldn't qualify.

Q. Unless it got new capital?

A. Unless it got new capital, but under present conditions that was the chief stumbling block.

The Court: How much capital?

A. $50,000 in an old company. A new company requires $200,000.

Mr. Jaegerman:

Q. If the contract liabilities of Fidelity were reduced so it had $50,000 for capital, I suppose that would also comply, would it?

A. It would comply, yes.

* * * * * * *

[fol. 2160] Q. Isn't this true, that in order to realize this 3½ per cent which you said it would be possible for you to do, that you would have to invest largely outside of U. S. bonds and state, county and municipal bonds and mortgages on real estate, and have to get into these semi-speculative [fol. 2161] or speculative corporate bonds and stocks?

A. Certainly you couldn't put a very large proportion in the highest grade bonds and earn 3½ per cent, but it would not be necessary to do that.

Q. And you would have to invest largely—chiefly—outside of the class of securities that insurance companies are permitted to invest their funds in under the laws of the State of New York and the twenty-five other states in the Union that follow the New York standards?

A. No, I would not agree to that.

Q. You would not agree to that?

A. No. You would have to invest more, but not the majority by any means.

Q. Insurance companies are not, under present conditions, realizing 3½ per cent average——

A. They are getting about 3.06—I mean the New York insurance companies are.

Q. So you have *to* got to improve on their earnings?

A. Yes.

Q. Are you familiar with the spread or difference between the average yield on the corporate bonds rated Triple A in

[fol. 2162] Moody's and U. S. Government securities—bonds?

A. No, I am not.

Q. I suppose you would agree with me—I want to base a question on it—that according to the report of the Temporary National Economic Committee that I have in my hand, pages 44 and 45, in 1939 that spread or difference between the percentage yield on U. S. Government bonds and Moody's Triple A corporate bonds was .49 per cent, and since it states that that yield on U. S. bonds was 2.36 per cent, that would mean that it would not be possible in investing in U. S. Government securities or Moody's bonds to get more than 2.85 per cent on those investments.

A. No, it would not, but I don't see why you would try to invest in Governments and Triple A bonds.

Q. That is the point. You would have to get outside of those safe and sound securities—have to leave that field entirely.

A. There are safe and sound securities that are rated Double B. They don't have to be Triple A to be safe and sound.

[fol. 2163] Q. You think this thing could be set up as you have outlined and that a salesman could go out in the field and sell it to investors?

A. I have so stated.

Q. Of course, you don't think, Mr. Young, that the investors could be induced to put their money in this company, reorganized, if it were explained to them that they could invest their money in government securities yielding 2.36 per cent or something like that?

A. I think the average one knows that. Anybody you go to see knows that from the publicity the defense bonds have had. May I say this——

Q. They know that, but they don't know that the yield by the company on the installments paid to maturity is only about 2½ per cent?

A. They know this if they can read. They know if they are paying a thousand dollars and getting $1,050 they are not getting any big rate of interest. They certainly know that.

The Court: Mr. Farmer, the same thing you are asking about has been gone over carefully and in detail by Mr. Palmer, and I don't believe you ought to encumber the rec-

[fol. 2164] ord by repeating his questions and drawing his inferences.

Mr. Farmer: All right.

Q. Now, you talked about a plan that you had here, and as I caught it your plan contemplated cutting down these old contracts, these special annuity and special income contract holders.

A. I didn't say I had a plan. I said that was one of the possibilities of working into a plan.

Q. You said first it might be made an insurance company.

A. I said that is possible.

Q. Do you know any insurance company that would undertake to issue policies to these contract holders, who have not been selected on any basis of risk, either age or sex or physical condition?

A. I didn't say I would give them an insurance policy. We would give them an insurance annuity.

Q. And cut down on the existing reserves that they have now?

A. Possibly. Those are details.

Q. You would have to do that?

[fol. 2165] A. Would you? Well, you answer that.

Q. You said you were going to cut them down about 20 per cent, didn't you?

A. I didn't say I was going to cut them down at all. I said that was one possibility.

Q. Didn't you say by cutting them down to about 80 per cent it might be done?

A. I possibly did, 80 or 70 or whatever it works out.

Q. If you will assume with me that there are some twenty million dollars of assets in this company, or better than that, which could be distributed among contract holders on the basis of their cash surrender values at the present time—cash liabilities at the present time—of about twenty-three million dollars, they could get that amount out of liquidation if you just sold them out and distributed the money, couldn't they?

A. I doubt it, after years of liquidation expense and the expense of litigation I don't think they would get anything like twenty million dollars.

Q. That would depend on court expense?

[fol. 2166] A. Yes, and you don't know what kind of market you are going to have by the time you liquidate. It

would take quite a while, in my opinion, to liquidate. It might drive the market down to the bottom when you start to liquidate, and instead of getting 70 per cent you might get 50.

Q. Those are conditions that you think might reduce the amount?

A. Easily.

Q. But what you are proposing to do is to cut down these old contract holders whose contracts at maturity would have to be much lower than 80 per cent wouldn't it?

A. Sure it would.

Q. And then invest the funds of this company in semi-speculative and speculative securities?

A. Well, if they didn't they would probably lose their money some other way in my opinion.

Q. Did you ever hear of Mr. Ponzi?

A. Yes, I have heard of him.

Q. He had his plan, didn't he?

A. Do you think that is comparable to ours?

[fol. 2167] The Court: Mr. Farmer, there is no use going into those matters that have nothing to do with this case. The Court doesn't like that.

Cross-examination.

By Mr. Huwe:

Q. Mr. Young, where the life insurance company makes a profit on its mortality rate, does Fidelity make a profit on the $700,000 between its reserve liability and its cash liability?

A. Yes, they have taken quite a profit there.

Mr. Huwe: Thank you.

The Court: Now, is there anything further with Mr. Young?

Mr. T. C. Townsend: Your Honor, I would like to ask Mr. Young some questions.

Cross-examination.

By T. C. Mr. Townsend:

Q. I believe you said yesterday when you were on the witness stand that it is your opinion, and gave reasons for

your opinion, that Fidelity could be reorganized under Chapter 10 of the Bankruptcy Act, did you not?

[fol. 2168] A. I did.

Q. Since you made that statement on yesterday have you received any information from any source that would strengthen that belief that you expressed that Fidelity could be reorganized?

A. I have, sir.

Q. What was it that you received that had a bearing upon that question?

A. I have been negotiating with a group of men in New York for some time. I first began negotiating with them with the idea of getting them to put additional capital in Fidelity, which, like a good many others, they couldn't see, naturally, and they were interested at that time of the purchase of Fidel; and since Fidel has ceased selling, in my opinion, it should be sold. At that time I wasn't sure it should be. It is profitable; we have a good sales organization; but times are entirely different. So for the last few weeks I have been negotiating with the same crowd to see if they would be interested in purchasing Fidel. I have done quite a bit of work. It is not a very easy thing to show [fol.2169] why anyone should buy it. And I have got a commitment from this group of men, very able men and very wealthy men—the list Mr. Dickinson has; I do not have the list with me—but they are men of unquestionable reputation and standing—and as an attraction to buying Fidel I intimated to them that if they were willing to put in a half million dollars and could work out a plan it might be possible to organize in some way Fidelity and throw the two together. I got a wire from them today. Would you like for me to read it?

Q. I wish you would produce the wire that you received.

(Witness produces paper.)

Mr. T. C. Townsend: Your Honor, that is not a very long telegram. I suggest that he be permitted to read it into the record.

The Court: All right. Go ahead.

Mr. Reinhardt: Your Honor, can't he read it, and the stenographer won't have to put it down in the record if it is going to be physically introduced.

The Court: Read it and let it be filed.

(The witness read the paper which is hereafter marked [fol. 2170] as Exhibit 90.)

The Witness: That is a group of men formed for just such purposes as this. It is a group formed for going into activities outside of their regular activities, some twelve or fifteen of them.

Mr. T. C. Townsend: I will offer it as an exhibit.

Exhibit 90

The paper referred to was admitted in evidence, marked as above indicated, and the same is attached hereto as a part hereof.

Q. Mr. Young, have you made any calculations to determine, if that offer was accepted by the trustee, the amount that would be received for the stock of Fidel?

A. I would say it would be between one hundred and one hundred and twenty-five thousand dollars.

Q. And what was the amount of the stock of Fidel now?

A. Fidel put in originally $125,000. They have taken out profits, management fees, I will put it, some one hundred and twenty-five or thirty thousand; and the account is liquidating very rapidly. They liquidated 20 per cent [fols. 2171-2178] in the last sixty days, which means, of course, the income that—every day we are getting surrenders it will become less and less.

Q. Is it the fact that it is being liquidated and the assets being distributed in the way of liquidation that causes you to express the opinion that it might not be unwise to sell it?

A. There is another reason for that. A New York office will have to be maintained for years because it is a New York corporation. There is no way of stopping it; there are contracts out and it is entirely solvent; and unless it is an active, going concern there is no way of making any money out of it for ten years; and another thing, it is not often you can get an offer on a security business like that. I wouldn't know where else to go to to get an offer.

* * * * * * *

[fol. 2179] Q. Mr. Young, did you open up negotiations with Pell?

A. Yes.

Q. When did you open them up?

A. I have had them going on for two years.

Q. You opened up since June 6th?

A. No, two years I said.

Q. Have you talked with them since June 6th?

A. Certainly I have, many times.

[fol. 2180] Q. Representing the trustee?

A. Representing no one.

Q. As a matter of fact, this was taken up with Pell and gone into extensively away back yonder and they declined to have anything to do with it.

A. Yes, with Fidelity.

Q. Mr. Koontz was up there, and Mr. Foulk——

A. Mr. Clarke and I, and we had a two day session.

Q. And they said they were not interested.

A. Yes, and as far as the group of men—I may say Mr. Koontz knows the majority of the men on here and will vouch for them being very high grade men.

Mr. Palmer: And it is true that they said they would not invest any money in Fidelity, after looking at all of the picture, getting the data and everything about it.

A. Fidelity, yes, sir, but they offered to buy Fidel at that time.

Q. And they still offered to buy Fidel, and they will seriously consider Fidelity?

A. That is right.

[fol. 2181] Redirect examination.

By Mr. Ray:

Q. Do you know whether, prior to all this litigation in which Fidelity recently — been involved, a new contract was being prepared which was proposed to be offered for sale in which the improvement rate would be 3 per cent?

A. I think that is a fact.

Q. If such a contract had been offered for sale, do you think the company would have been able to perform its promises therein?

A. Under that contract?

Q. Yes.

A. I feel quite sure they would.

Mr. Ray: That is all.

Recross-examination.

By Mr. Reinhardt:

Q. Mr. Young, does this wire say it will be confirmed by letter?

A. Yes.

Mr. Reinhardt: We want to offer the letter when it comes. [fol. 2182] Mr. Palmer: We want to object to the letter coming into the record at all.

The Court: I overrule your objection.

The Witness: I wonder if you want put in the record the group who compose Pell, Limited?

Mr. Reinhardt: That is what I was going to ask you next. Mr. Young, will you furnish the reporter with the original of that letter when you have received it?

A. Yes.

Q. Can you tell us who constitutes this Pell, Limited, which signed this telegram?

A. I can't offhand, but I will be very glad to give you a complete list in the morning. Mr. Dickinson has it, and I thought he was going to be here this afternoon—about fifteen of them.

Q. Suppose you include that with the letter itself.

A. Yes, sir.

Re-cross examination.

By Mr. Farmer:

Q. You have been here all week?

A. Yes, sir.

[fol. 2183] Q. You have not talked with them since last week?

A. Yes, I have talked to them on the telephone. They made me an offer last week, and I asked them to confirm it, and they wouldn't do it until they got a balance sheet and income statement, which I sent them by air mail.

Q. Did you explain to them it would be impossible to find out whether the Court had jurisdiction within thirty days?

A. I told them I didn't know how long it would take. I could probably get that extended. I don't know.

Mr. Palmer: Q. Mr. Young, may I ask in these negotiations since the 6th of June, are you purporting to represent

the trustee, purporting to represent the group of gentlemen who are making the offer, or are you acting independently in the hope of getting a commission from one or the other?

A. No, I do not expect to get a commission from anyone. However, if someone else sold it they would ask for a commission. I am doing it like I would any other security I think should be sold. It is becoming a liability instead of [fol. 2184] an asset. You keep it six more months and Fidel will be losing money every month.

Q. Your position is you are acting as a former officer of Fidel in trying to get this sold? Is that right?

A. As I would any other security in our portfolio.

Q. Beg pardon?

A. As I would any other security in our portfolio.

Cross-examination.

By Mr. Reinhardt:

Q. Are you still in charge of the Fidelity portfolio?

A. I am working for the trustees.

Q. Do you still have duties with respect to the supervision of the Fidelity portfolio?

A. Yes, sir.

Mr. Palmer: Q. Then you are working for the trustee at the present time and in the sale of this asset?

A. No more than I would anything else in the portfolio. I am supposed to advise the trustee if I think something should be sold.

[fols. 2185-2186] Q. My question wasn't what you were supposed to do; my question was whether you were working for the trustee.

A. Certainly I am working for the trustee.

John Marshall, Sr. recalled, testified as follows:

Direct examination.

By Mr. Ray:

[fol. 2187] Q. Mr. Marshall, I hand you the minute book of the company, which has previously been marked Exhibit D for identification, with the understanding, I believe, that any pertinent minutes therein contained may be intro-

duced in the record as a part of the evidence. Will you please turn to page 154 to the minutes of a meeting of the directors held on December 23, 1940?

A. Yes, I have that.

Mr. Ray: We now want to offer the minutes of this directors' meeting in evidence and have it marked with the proper exhibit number.

Mr. Palmer: May I look at it before that is done?

(Witness hands book to Mr. Palmer.)

Mr. Palmer: Your Honor, we object to the introduction [fol. 2188] of these minutes. The purpose is obvious, that the minutes as signed by Mr. McNulty, set up that six directors present constituting a majority of directors. That doesn't have anything to do with whether the by-laws are correct in stating that seven is a majority and is so applicable.

The Court: Seven is a majority or a quorum?

Mr. Palmer: It says "constituting a majority of directors."

The Court: I don't remember anything in the by-laws that says seven is a majority.

Mr. Palmer: No, you are correct, your Honor— my mistake; but outside of that I can see no relevancy in the entire minutes, and if Mr. Ray will be kind enough to point out the relevancy perhaps I will agree to the introduction of it.

Mr. Ray: If it please your Honor, it shows the interpretation put on the by-laws of the company by the company, and it shows that the general attorney of the company, Mr. Foulk, was present at that meeting, and the presumption would be that that was his opinion that that was a proper interpretation of the by-laws. It is simply offered for [fol. 2189] what it is worth.

The Court: Well, if it is shown in this meeting that the company elected somebody else who constituted the seventh director, that would be admissible.

Mr. Ray: That is exactly what it does, and that is the purpose for which it is offered.

The Court: I overrule the objection. As I understand, Mr. Palmer still objects to that, even so.

Mr. Palmer: Yes, your Honor; this is merely the writing up of the minutes by Mr. McNulty, the secretary. I don't

find any other signatures by the board of directors on that minute book. The fact that it states that there was a majority of the directors doesn't have the slightest thing to do with the by-laws, which provide a certain way to form a quorum; and what the company did or what six directors did does not change the by-laws unless it was specifically so voted.

The Court: As I understand, Mr. Ray is not making any point of the statement that that constituted a majority of the directors.

Mr. Ray: No, your Honor.

The Court: Mr. Ray's purpose is to show that a meeting [fol. 2190] took place at which six directors were present, and that those six elected a seventh director, which constituted a quorum. I admitted evidence of that kind before, and I think, to be consistent, I will have to admit that now.

The Witness: Of course, I wasn't present at this meeting, your Honor——

Mr. Palmer: We object to having the rest of the minutes in that do not bear upon this particular question.

The Court: Well, that might have some bearing. I will let the minutes of that meeting be introduced.

EXHIBIT 91

The minutes of the meeting referred to were admitted in evidence, marked as above indicated. The same are attached hereto as a part hereof.

Mr. Ray: Q. Mr. Marshall, was a special meeting of the board of directors of Fidelity Assurance Association held, after being called and notice given, at 12 o'clock noon at the Daniel Boone Hotel, in the City of Charleston, West Virginia, on Wednesday, September 17, 1941?

Mr. Palmer: Objection.

[fol. 2191] A. That is correct.

Mr. Palmer: Any meeting held after the institution of this proceeding would be entirely irrelevant as to anything going on in these proceedings, so there would be no need of putting in any evidence about that meeting.

The Court: I don't know whether it would or not until we hear what happened at it. I overrule the objection.

Mr. Ray: What was the answer?

A. That is correct.

Q. Did you act as secretary of the meeting?

A. I did.

Q. Have you prepared the minutes of the meeting?

A. Yes.

Q. Do the minutes as prepared by you correctly show what took place at the meeting?

A. To the best of my knowledge and belief.

Q. Have you placed the minutes of the meeting in the minute book of the corporation?

A. That is right.

Q. On what pages of the minute book are those minutes? [fol. 2192] A. They follow the ratification, which is also placed in the minute book by Mr. Burt, between pages 176 and 177; and the minutes of this meeting of September 17th begin on page 177 of the minute book.

Mr. Ray: We now offer the minutes of this meeting of the board of directors in evidence.

Mr. Palmer: May we see them, your Honor?

The Court: Yes, go ahead. I would like to see them too before I pass on it.

Mr. Jaegerman: Your Honor, might that not be read off the record so we can hear what it is?

The Court: Yes, that may be done.

(The minutes referred to were read.)

Mr. Palmer: If your Honor please, I object. Mr. Wheeler Bachmann, who was mentioned there, was not qualified as a director at that time, having refused to qualify as a director prior to June 3, 1941.

Mr. Ray: Your Honor, that is a matter of fact that is not true because he says so. Here are the records of the corporation, and the records show that he was elected.

The Court: We have had this read, but, as I understand, [fol. 2193] it has not gone in evidence yet. Did you offer to introduce that in evidence?

Mr. Ray: Yes, I offered it before it was read.

The Court: Is your objection directed to the offer of Mr. Ray?

Mr. Palmer: Yes, your Honor.

The Court: I will overrule that particular objection, because I think Mr. Ray is right, in that there has been no showing made that such is the case.

Mr. Palmer: I think, your Honor, it was shown earlier

that Mr. Bachmann wasn't qualified as a director. I believe the answer of the Auditor under oath set that fact up, that Mr. Bachmann did not qualify as a director.

The Court: But there is nothing to show just what did happen with Mr. Bachmann.

Mr. Palmer: The answer says, "At the previous annual meeting of the stockholders of the debtor held on February 21, 1941, fourteen stockholders were elected to the board of directors, of whom four, namely, Arthur B. Koontz, Wheeler C. Bachmann, Walter T. Grosscup and Tom B. Foulk have either refused to serve as such or had resigned [fol. 2194] prior to the purported meeting held June 3rd, 1941." I do happen to know of my own knowledge that Mr. Wheeler Bachmann informed me that he had refused to qualify, and he informed me after the federal court proceedings were brought here, and he said he would not qualify because he did not have time to serve and had refused so to qualify. Until there is proof made of Mr. Bachmann's qualifying as a director, we object on that ground. We also object, if your Honor please, on several other grounds.

The Court: Well, let's take that ground first. What is your ground for saying that if he failed to qualify before June 6th he could not qualify afterwards?

Mr. Palmer: I don't know whether he resigned or refused to qualify, and those facts are set up in the Auditor's answer, but I would like to be given time to find out about that it is—nearly adjournment time—before the Court rules on this, so I can be fully advised as to the facts.

Mr. Ray: Your Honor, that is something he could show when he puts in his case. We bring you the minute book, which is presumptively correct. There are the minutes of [fol. 2195] the corporation. The minute book shows that he was elected. There is no record of a resignation. The minute book shows that he appeared at the meeting, that he made motions, and it certainly would be presumed that he qualified and was acting as a director; so certainly the minutes are entitled to be filed. If he wants to come along later and introduce evidence to show that he was not qualified, he would have a right to do it.

Mr. Palmer: If your Honor please, if I am not mistaken there is evidence in this case already that at the time of the meeting in Pittsburgh there were a certain numbers of directors, one of whom was not Wheeler Bachmann.

Witness after witness testified under oath as to all of the directors of the company, and that Wheeler Bachmann was not one of those directors at that time.

The Court: What I am asking you now is, on what do you ground your statement that if he wasn't a director at that time he can't have been a director on September 17th?

Mr. Palmer: There is nothing to show that he was re-elected to the board of directors since June 6th or that he [fol. 2196] was ever elected to the board of directors between June 6th and the present date; and the mere announcement by a writing such as his that he was a director does not make him so.

Mr. Kay: I think that is the best evidence of whether he was a director or not. I think that is the best evidence that can be produced as to whether he is a director; and the only way that it can be shown that he is not a director is to show that those minutes are false and incorrect.

Mr. Palmer: All right; here is the testimony of Mr. Messick, Chairman of the board, under oath, and he mentions those who were at the Pittsburgh meeting, and Mr. Burt and Mr. Risley absent.

"Question: And they were the other directors?

"Answer: Yes.

"Question: How did you arrive at that number? I think the minutes of the stockholders' meeting of that year, or the year previous, showed the election of 14 directors.

"Answer: That is right, but a number of the men elected as director did not qualify.

[fol. 2197] "Question: Refused to serve?

"Answer: Yes.

"Question: And that left these eight?

"Answer: That is right; that left eight.

"Question: At the time this meeting was held there were only eight directors?

"Answer: That is right.

"Question: And six of those were there?

"Answer: Yes, six were there."

The Court: But, Mr. Palmer, is it your position that because he failed to qualify at one time and therefore wasn't eligible to sit at that day, he couldn't come in later and qualify and sit in a meeting?

Mr. Palmer: Yes, your Honor, if the gentleman refused to qualify as a director and thereby refused acceptance of

that position, it left it open for a new one to be elected in his place.

Mr. Reinhardt: And suppose he failed instead of refusing?

Mr. Palmer: This says, "Refused to serve."

The Court: Well, he failed to qualify and refused to serve at first.

[fol. 2198] Mr. Ray: Those directors who were elected at the stockholders' meeting; some of *the* them didn't have the capital stock and couldn't qualify. Others, I think Mr. Bachmann and Mr. Grosscup, did have the capital stock; and they are directors, in our opinion, of this corporation until they resign and their resignation is accepted.

Mr. Palmer: If your Honor please, we have the Chairman of the board of directors under his oath in this proceeding stating that Mr. Wheeler Bachmann is not a director as of June 6th.

Mr. Ray: Where did he say he wasn't a director?

Mr. Palmer: If you will read the record, Mr. Ray——

Mr. Ray: You read it. What you read doesn't say it.

The Court: It seems to me all that says is that he was not at that time a qualified director.

Mr. Palmer: No, it says there were only eight directors at that time. Now, in order to make that man a qualified director now, there would have to be some action between the 6th of June and now, none of which is shown.

[fol. 2199] The Court: But may it not be presumed until you show the contrary?

Mr. Palmer: A condition once existing is presumed to continue until the contrary is shown, and it is shown that he was not a director, and that condition will be presumed to continue until proof is offered that he was a director.

The Court: I don't think it was shown that he was not a director; it just says up to that time he had not qualified.

Mr. Palmer: The record says there were only eight directors, and names them, if your Honor please, if I may read that.

"Question: Who were the members of the board of directors at that time?

"Answer: It was Mr. F. S. Risley and Mr. Austin King——

"Question: What about Mr. Burt?

"Answer: Mr. Burt, yes, of Wheeling.

"Question: Well, Mr. Burt and Mr. Risley were absent?

"Answer: They were absent.

[fol. 2200] "Question: And they were the other directors?

"Answer: Yes.

"Question: How did you arrive at that number? I think the minutes of the stockholders' meeting of that year, or the year previous, showed the election of 14 directors.

"Answer: That is right, but a number of the men elected as director did not qualify.

"Question: Refused to serve?

"Answer: Yes.

"Question: And that left these eight?

"Answer: That is right; that left eight.

"Question: At the time this meeting was held there were only eight directors?

"Answer: That is right.

"Question: And six of those were there?

"Answer: Yes, six were there.

"Question: How did it happen Mr. Burt did not come?

"Answer: Mr. Burt informed us he was attending a telephone meeting at Charleston.

"Question: What about Mr. Risley?

"Answer: Mr. Risley, I was informed, wired he was [fol. 2201] unable to be there."

And that is all the direct examination by the debtor of Mr. Messick, Chairman of the board, and now they attempt to contradict that.

Mr. Ray: We don't attempt to contradict anything, your Honor. We introduced the corporate record which shows that Mr. Bachmann was elected a director, that he came to this meeting, that he served as a director, and there is nothing in those minutes to show that his resignation was ever accepted. I am willing to ask the witness, if it is necessary, whether his resignation was ever accepted. I don't think it is necessary, because I think it will be presumed.

Mr. Palmer: A man doesn't become a director until he qualifies.

Mr. Ray: And I think in this case he qualified by coming to the meeting and serving as such, if he had the capital stock.

Mr. Palmer: And if he refused to serve there is a vacancy immediately created on the board of directors. The Chair-

man of the board has said there were only eight directors at the time of the meeting in Pittsburgh. If you want to [fol. 2202] bring in another man as director, you must bring in some proof of his election since that time.

The Court: Mr. Palmer, the Court is not going to pay any particular attention to the testimony referred to by Mr. Messick, because it is apparent that Mr. Messick was thinking of that occurrence from a different angle to the one from which you are thinking of it. Now, even if he is mistaken, the Court is interested in getting at the truth; so if Mr. Bachmann was a director, and was able to serve, then the fact that some witness in the proceeding said he was not would not interfere with the Court's decision.

I think the real ground of your objection that the Court would want to consider in determining whether to sustain it or not would be whether a director who is elected, by failing to qualify and refusing to serve at some particular meeting, thereby loses his office as a director without the necessity of any acceptance of his resignation or otherwise. It seems to me that is the legal point. Now, what is your position on that, Mr. Ray?

Mr. Ray: Your Honor, I say that all this record shows [fols. 2203-2210] is that Mr. Bachmann was elected a director at the stockholders' meeting in February. I think there were two directors' meetings at which he was not present. There is nothing in there about his refusing to qualify or refusing to serve. He just was not present at those meetings. Then at this meeting there is a minute showing he appeared as a director. He took part in the meeting, he made motions and voted and served as a director, and I say that record, which is the record in this case, clearly shows that Mr. Bachmann is a director of this company.

Mr. Huwe: Your Honor, may I be heard? What difference does it make that Mr. Bachmann didn't participate in the resolution with reference to the filing of the petition or a new petition? In other words, we had a quorum of seven without Mr. Bachmann.

Mr. Palmer: No, they didn't, not until they elected a new one.

. . . . . .

[fol. 2211] The Court: Gentlemen, the Court is ready to take up any motions that are proper to be taken up at this time.

(Several motions in writing which had previously been filed were thereupon argued by counsel, off the record.)

Stipulation

Mr. Eney: Your Honor, for the purpose of my motion I would like to have it stipulated that figures shown by the exhibit previously introduced, that the par value of the Maryland deposit as of June 6, 1941, was $600,000; that its market value as of that date is $470,806.25; that the net reserve liability of Fidelity Assurance Association to the Maryland contract holders is $508,163.70; that the net cash liability is $492,552.24; and the term "net" in connection with both the reserve liability and cash liability means the total liability less the amount of loans made to contract [fols. 2212-2315] holders.

The Court: Isn't that already in the evidence?

Mr. Eney: It is in evidence in the other case, but my motion is no part of the other case, and I wanted it for the purposes of this case.

* * * * * * *

[fol. 2316] H. Isaiah Smith recalled, testified as follows:

Cross-examination.

By Mr. Lauritzen:

Q. Mr. Smith, there has been some testimony here con-
[fol. 2317] cerning federal income tax liability of Fidelity Assurance Association with respect to a certain deficiency assessment that has been levied. Can you give us any information on that?

A. During the period of the state court receivership the Internal Revenue Department sent their agent in to work up a report on the income of the company from 1935 up to date, and there was an assessment made of approximately—I think $265,000. Before the time expired for appealing the case the trustee was appointed and an extension was granted for filing the return, and at the present time auditors have been engaged in going into the matter and seeing

whether or not it is the correct amount, and then—with the thought in mind of fighting the case clear through to the Internal Revenue Commissioner.

Q. By auditors do you mean employees of the trustee in this case?

A. No, an independent auditor has been employed.

Q. Has been employed by the trustee?

A. Yes.

Q. Who are they?

[fol. 2318] A. Haskins and Sells.

Q. Can you tell me for what years this deficiency assessment was levied?

A. From 1935 to and including 1940.

Q. That is for the income tax years 1935 to 1940, inclusive?

A. That is right. I know it begins in 1935. I think it includes 1940.

Q. Is that an assessment that is levied against Fidelity as a whole, as a corporate entity, or is it levied against some fund or intra-corporate entity of some sort?

A. It is levied against Fidelity as a whole. However, the tax is computed on the income of the various reserve funds, but I repeat the assessment is made against Fidelity Assurance Association as a whole without any breakdown with reference to the various reserve accounts.

Q. Can you tell me whether they charge that the so-called general fund had any income in any of those years?

A. No, I don't know.

[fol. 2319] Q. Mr. Smith, you previously prepared a certain statement which has been introduced as Exhibit 48, showing the deposits by states as of June 6, 1941 and the liabilities by states as of that date. You are familiar with that?

A. I believe the liabilities as of April 10th.

Q. Oh, yes, excuse me; liabilities as of April 10, 1941. Now, you list the total market value of deposited securities at $20,056,680.27. Then under that there is an item entitled "Not deposited securities," having a market value as stated here, of $556,467.51. Can you tell me what is the nature of those securities and what is the reason that they were not deposited?

A. That is on deposit as of June 6th?

Q. Yes, sir.

A. Those were securities that we had in Wheeling that were turned over to the trustee on June 6th. Most of them belonged to the general fund. Some were common stocks and there was some mortgages, and, oh—a few odd lots of FHA mortgages probably that belonged to the—not particularly FHA mortgages, either, but just odd lots of securities that were not on deposit belonging to the con-
[fol. 2320] tract funds. The amount would be insignificant, however.

Q. They have a total market value of $556,000?

A. I meant in securities that belonged to the contract funds. Most of the five hundred and odd thousand are securities belonging to the general fund. Does that answer your question?

Q. Yes, almost. Can you tell me how these securities happened to be there in the general fund and not on deposit?

A. The general fund securities were not required to be on deposit, is my understanding.

Q. Can you tell me whether these securities comprising this $556,000 item would be eligible for deposit under the laws of the various states?

A. Most of that was not eligible.

Q. You say some of those are common stocks. What sort of common stocks?

A. I can't name offhand the companies, but I do know that there is some Wheeling Steel and Hartford Rayon and various common stocks. I can't name them offhand.

Q. Were these stocks purchased over a long period of
[fols. 2321-2329] time by the general fund, if you know.

A. I don't know.

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[fol. 2330-2337] Mr. Palmer: Oh, yes, I presume he will get that.

I am not certain that this has been asked. If it has, the Court will stop me. It is true, is it not, that you, as a state court receiver, did not receive any of the state deposit fund that was under the control of Mr. Sims, but he retained that all during your state court receivership?

A. That is correct.

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[fol. 2338] Mr. Palmer: We are going to ask the Court's permission to call the gentleman who is here from the State of Ohio as its official representative to state on the witness stand what happened to this proceeding and how they were taken care of, in order to show the Court that they will not interfere with proper proceedings by statute.

The Court: That will be all right. It will not be necessary for him to take the stand. Let him state his name and his official capacity.

Mr. Dunifon: My name is Dale Dunifon and I am First [fol. 2339] Assistant Attorney General of the State of Ohio.

If the Court please, in Ohio with reference to the liquidation of deposits of insurance companies and bond investment companies, our law has been held to be exclusive by both the Supreme Court of Ohio and the Federal Circuit Court of Appeals of our circuit. A receivership action was instituted in the Common Pleas Court of Franklin County by John A. Lloyd, Superintendent of Insurance of Ohio and, by virtue of his office, supervisor of bond investment companies, at the request of either the State Auditor of West Virginia or the state court receivers, I am not sure which. That receivership proceedings was for the sole and exclusive purpose of taking possession of and protecting assets of less than $10,000, which represented cash in banks, furniture and other small assets throughout the state, and had no connection whatever with the statutory deposits and was not the type of proceeding that would subject those deposits to liquidation, and the superintendent of insurance only took control over assets totalling some six or seven thousand dollars.

The Court: Was this proceeding ancillary to the West [fol. 2340] Virginia proceeding?

Mr. Dunifon: He asked for an ancillary receiver in Ohio, yes, sir.

After that suit had been filed for some several weeks and after the restraining order approved by this Court—I may be wrong in the date, but I think after the date of this Court's action—Mr. Huwe and Mr. Rivers appeared before that Court as the Court related to me, because we were not notified, and during a recess obtained the right to intervene, or rather file a cross petition. Prior to that both the super-

visor of bond investment companies and the Attorney General's office had received letters and telephone requests from Mr. Rivers and Mr. Huwe to proceed at once to liquidate the Ohio deposit, because the people they represented were not interested in any type of reorganization.

After the hearing in the Common Pleas Court we were notified the next day by reading the Daily Reporter, that the Treasurer of State had been made a party defendant, and that in the cross-petition of Mr. Huwe and Mr. Rivers they sought to liquidate the two statutory deposits in Ohio. [fol. 2341] I then called to the Court's attention, by telephone, the restraining order that had been put on in this cae. It was then that he explained that he had been in the trial of a criminal case, that representations were made that these gentlemen were from out of town and it was rather a pro forma matter and the Attorney General's office needn't be notified of it in advance.

The Court then instructed the Attorney General's office to notify Mr .Huwe and Mr. Rivers that he felt that they had taken advantage of him, and that they should, of their own motion, ask to have the order vacated. Mr. Rivers was called by telephone and he said he would get in touch with Mr. Huwe, and they promised to take immediate action. Some eight or ten days went by and the Court called me and asked me what had happened to these lawyers. He then told them that if they were not present in Court by such and such a day the order would be vacated. They then appeared in Court on that day, Mr. Huwe and Mr. Rivers. The argument was presented by the Attorney General's representative's that in that type of action, which was not a mandamus action, which their clients had the right to [fol. 2342-2343] resort to, but that was not the type of action that this was—and only by making a demand on the supervisor of bond investment companies or the Attorney General, and then attempting to mandamus them, could they have those deposits in Ohio liquidated. Cases were cited, and the Court then entered an order nunc pro tunc which vacated the previous order making Mr. Huwe's and Mr. Rivers' clients parties, and that case has now been closed and the costs paid.

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[fol. 2344] Q. Mr. Smith, you testified that there were certain assets which the West Virginia State Court Receivers

[fol. 2345] took over upon their appointment and others that were in the State of West Virginia which they did not take over. Is that correct?

A. That is right.

Q. What is the difference between those two groups of assets?

A. Well, the assets that we took over was the cash in banks, securities—undeposited securities in the Wheeling office and certain undeposited securities in the bank vault of the Dollar Savings and Trust Company. The assets we didn't take over were the assets on deposit with the State of West Virginia.

Q. Why not?

A. Well, so far as I know, Mr. Reinhardt, there was no formal demand—in fact, there was no formal demand made for those securities by the receivers.

Q. Why wasn't there a formal demand made?

Mr. Palmer: That may be a legal question, your Honor, that perhaps Mr. Smith can't answer. I am not suggesting that it is.

A. Mr. Palmer, I was just about to say that the attorneys [fol. 2346] for the trustee had not given us advice in any way as to how to acquire those securities or whether or not it was our responsibilities to take them into our possession.

Mr. Reinhardt: You mean the attorneys for the receivers?

A. Pardon me—attorneys for the receivers.

Q. That is, when you refer to the attorneys for the receivers, you mean Mr. Thomas?

A. Mr. Thomas was a co-receiver—one of the receivers—and I counselled with him on legal matters.

Q. Who did you refer to when you say "The attorneys for the receivers"?

A. The attorneys for the receivers are the firm of Koontz & Koontz.

Q. Mr. Thomas was then a member of Koontz & Koontz?

A. I presume that he was. I didn't have any knowledge of him resigning from the firm.

Q. Did the question ever arise in any discussion that you had, either with Mr. Thomas or with any other member of the firm of Koontz & Koontz, as to what the duty of the receivers was with respect to taking possession of the assets

[fol. 2347] that were on deposit with the State of West Virginia?

A. That was never discussed, to my knowledge.

Q. Did you exercise any control or did you have any conversations with anybody respecting the assets that were deposited with the State of West Virginia?

A. You mean with reference——

Q. As a receiver.

A. You mean with reference to taking possession of them?

Q. Any kind of conversations about them at all.

A. No, other than the discussion I had with the State Auditor with reference to letting us withdraw the stock certificates issued in the name of the association representing the capital stock of Fidel. We wanted the stock transferred to our names, and the Auditor permitted us to make that exchange, substituting the certificate issued in our name for the one that was on deposit with the State Treasurer.

Q. You know about these deposits of West Virginia securities?

A. I certainly did.

Q. But the question of whether you should take posses-
[fol. 2348] sion of them never occurred to you?

A. No, sir.

Q. Had you formed any opinion as to what your duties as receiver were with respect to those assets?

A. No. I was depending on the advice of counsel, if we were supposed to take them into our possession.

Q. Well, as receiver you contemplated that some time there might be a distribution of the assets that you were administering?

A. Oh, certainly.

Q. Did you ever consider what assets would be distributed and how and whether they would include these deposited securities?

A. I most certainly did.

Q. Did you talk about it to anybody?

A. You mean about the possibility of selling and distributing the assets?

Q. Of you as receiver doing that.

A. Yes. Of course, as receiver I knew these assets were property of the—of the association, and if and when the

time came that we were to liquidate it would be necessary [fol. 2349] for us to acquire possession of them in order to dispose of them.

Q. That includes the assets that were deposited with the State of West Virginia?

A. That is right.

The Court: I think the question was whether he had ever conferred with anybody.

Mr. Reinhardt: I was going to follow that up.

Q. Did you discuss that with anybody?

A. Oh, Mr. Thomas and I, of course, discussed those general policies as to what we could do in the case we couldn't work out a plan of reorganization, that it would be necessary to liquidate the securities, but as to the mechanics of getting those securities into our hands, there was no definite policy established on that at all.

Q. Well, I wonder whether that is true, in the light of what you say. Was it the decision that you arrived at in your conferences with Mr. Thomas that pending efforts to work out a plan of reorganization, the securities deposited with West Virginia might be left where they were and then if you worked out, or if a plan of reorganization were worked out in the receivership which required anything to [fols. 2350-2353] be done with those deposits, that would be the time to——

A. That is what I intended, Mr. Reinhardt, my answer to be to your question.

Q. So that there was that definite policy?

A. Yes, sir.

Q. It may not have been adopted as a statement of policy, but that was your conduct with regard to those securities?

A. Yes, sir.

Q. But also, if there were no reorganization in the state court, but a liquidation, that at that time you would have to take over these deposited securities and liquidate them?

A. That is right. I might further add, I stated that the only time we entered the boxes, the deposit boxes of the securities—was when this exchange of the Fidel stock certificates, but we did ship down to Charleston securities worth approximately—the market value was approximately $500,000 and placed them on deposit. That was along about the 8th day of May. And then we cut the matured coupons for the month of April, I believe.

[fols. 2354-2358] Q. Up until the time that you were superseded as receivers you hadn't even got to the point of being able to start on any plan of reorganization, had you?

A. Oh, most certainly not. As a matter of fact, the life of the receivership was less than two months, and we were making preparations for an audit of the firm so that we could see just where we stood in order to be able to give some thought to a plan of reorganization.

Q. So that you were just barely beginning your duties when you were superseded? Is that right?

A. I should think that is perfectly obvious, that with a concern of this size we didn't have time to have any plan worked out.

Q. With reference to the state deposit in West Virginia, as receivers you never made any demand on Mr. Sims for that fund, did you?

A. No, sir.

[fol. 2359] Q. So that the ultimate question of who should convert the securities into cash had not been presented by you as receiver to your legally appointed counsel for the purpose of their determination?

A. I believe I have previously so stated.

Q. And the question of whether or not you were an agent of Mr. Sims or were a receiver of the state judicial branch of the state government had not been discussed or determined by your counsel? Isn't that true?

[fol. 2360] A. No, it had not been determined by counsel. I just as a layman had assumed that I was an officer of the Court, and so regarded myself.

Q. And it was just your own opinion and not the legal opinion rendered to you as receiver?

A. That is right.

Q. If it had been ultimately determined in the state court proceeding that no reorganization could be had, were you and Mr. Thomas prepared to do whatever you were legally advised was the law with reference to liquidating any securities and distributing the proceeds thereof?

A. Yes.

Q. Do you know, of your own knowledge, how far anything had been done towards starting to formulate any plans of reorganization?

A. You mean any state? Had been planned by any state?

Q. No, any plan of the receivers, you and Mr. Thomas,

whether you had talked of any, thought of any or begun to formulate any, or what the situation was.

A. Oh, yes, we had talked about a plan, but we had not [fol. 2361] been able, or didn't have time, of course, to work it out, but it had been under discussion many times.

Q. And was it your intention to attempt to formulate some plan of reorganization in the state court?

A. That was our intention, yes.

The Court: Mr. Smith, in discussing the plan between you and Mr. Thomas, what part in that plan did the deposits with the State of West Virginia have?

A. Well, we—in discussing—in discussing a plan we first had in mind to work out a plan in which all the assets of the association would come into us, or the state receivers would work with us, realizing from that standpoint that if we had obstacles of any other state attempting to liquidate or failing to cooperate with us, that that would affect our plans, we would have to go back and work it over to take into account the securities that might be on deposit in that particular state.

Q. That is with reference to the outside states. I am asking you now what part in this plan was played by the deposits that you had in the State of West Virginia—that Fidelity had in the State of West Virginia?

[fol. 2362] A. We had not gotten that far, your Honor, as to just how we would proceed if and when it was determined that the only deposit we could administer would be the West Virginia deposit. We had not gotten that far along.

Q. But whatever plan you had under consideration involved administering by the receivers of this lot of securities that was on deposit with the State of West Virginia, didn't it?

A. Your Honor, we felt that we could administer this deposit, but any such plan as we had talked about took in the securities in all the states, with the hope that we could secure co-operation with the state authorities or receivers that might be in other states; so, as I say, we had not talked of a plan that would just confine it to the West Virginia deposit alone.

Q. Well, it was your theory, was it not, that you could handle these securities in West Virginia, including the securities on deposit with the state—could handle those

by virtue of your appointment by the Circuit Court of Kanawha County, and the others, if they came in the plan, would have to come voluntarily through action of the various state depositories and receivers?

[fol. 2363] A. That is right.

The Court: All right.

Mr. Palmer:

Q. Mr. Smith, isn't it rather the fact that you contemplated that Auditor Sims would co-operate with you in any plan that you formulated and would agree to go along with anything that you thought reasonable?

A. Yes, we anticipated discussing freely with Mr. Sims such plans as we might formulate.

Q. When you informed the Court that you had contemplated the administering of this fund, you didn't mean to tell him, did you, that you contemplated physically taking it from Mr. Sims' possession, but rather that you contemplated having a plan with which he would agree and go along?

A. I don't believe I understand your question, Mr. Palmer.

Q. What I want to know is, did you in your own mind first contemplate a reorganization plan which contemplated you, as a receiver, physically taking the assets in the State of West Virginia on deposit there into your possession and administering them, or did you contemplate in that reorganization plan presenting the plan and having Auditor [fol. 2364] Sims agree to go along with your plan?

A. We had not anticipated taking physical possession of the securities, but we certainly anticipated that we would have control of them to the extent of fitting them into the plan, but as for taking physical control, why, I believe I have previously said that we had no advice on that matter at all.

Q. And your plan that you hoped to effect was that not only Mr. Sims but all of the other state officials where there were deposits would agree to co-operate and allow a pool to be formed upon which the plan could operate?

A. That is the only way it could be done.

Mr. Reinhardt: That is contrary to the witness's answer to the immediately preceding question.

Mr. Palmer: What was his answer to this question?
Mr. Reinhardt: I am objecting on that ground.
The Court: Read the question.

(The question was read.)

The Court: If the witness understands that question I will permit him to answer.
A. I believe in reply to the Court a while ago I answered the substance of that question.
[fol. 2365] The Court: He said a while ago that he contemplated that while they probably would not take physical possession, that they would have control. If this question is explained to the witness I will permit it to be asked and answered.
Mr. Palmer: What was the answer?
The Court: Let's hear the question.

(The question and answer were read.)

The Court: Do you mean by that answer, Mr. Smith, that you now retract what you said about the receivers having control of the state fund?
A. No, your Honor. When he referred to a pool pooling all the assets I didn't understand that question to mean that that required all the assets to be brought in.
Mr. Palmer: No, not physically, but to be available for the purposes of the plan left where they were. Wasn't that your attempt?
A. If I understand your question aright, Mr. Palmer, my answer was designed to—strike that—my answer was supposed to have been, or is, that if we were to work out a plan that we would ask the co-operation of all the state [fol. 2366] officials and holding in status quo these securities until such time as the plan was accepted by the contract holders.
Q. And then you would ask the state officials to allow that plan to operate on the contract holders and the fund in their states?
A. I believe that is covered in my answer.
Q. Is my understanding of it correct?
A. Yes, sir.

The Court: Let me make this observation. This line of testimony, as I see it, although the purpose of it has not been explained, the only purpose that I can see to be at-

tained by this sort of testimony is to find out what the policy and the attitude and the opinions of the receivers were before the proceeding was begun in federal court with reference to whether or not they had the right to administer this fund on deposit in the State of West Virginia. The only bearing that that would have, as I can see it, is that if while they were state receivers and in charge of the assets of the company that was their policy and that was their attitude and that was the position they took, then [fol. 2367] they should not be permitted to come into this proceeding and take an inconsistent attitude. If the Court has the right slant on the purpose of that testimony I would like to know, or if I don't have I would like to know.

Mr. Palmer: No, your Honor, we don't want the opinions of any witness.

The Court: No, I don't mean their opinions now. I mean their testimony now of what their opinions were then.

Mr. Palmer: No, your Honor, I have not asked that. That was developed by Mr. Reinhardt. I don't think it is pertinent or proper. I think that what the law of West Virginia was at that time is the only guiding factor that could guide this Court or could have guided those receivers, regardless of their personal opinion; that the statutory law of West Virginia was binding up on them and the State Auditor. What I have attempted to ask Mr. Smith is to show what these receivers were actually trying to do, in order to show to this Court that there was a pending proceeding in which a proper remedy for this debtor could have been had and was being attempted to be had when this came in. I want the facts and not opin- [fol. 2368] ions other than the fact as to what they were then doing and attempting to do. I do not want the opinion of the witness as to the legal situation between himself and the state court and the State Auditor, and I think that that is a matter of law which the state statutes clearly decide and not a question of opinion for either lay witness or expert witness or otherwise.

The Court: Then you and counsel for the SEC are approaching this matter with different purposes in mind?

Mr. Palmer: Apparently. I am approaching it, as I will state to the Court—I don't think the questions of the gentleman from the SEC as to the opinion of the witness are pertinent at all to the matter I am trying to develop.

Mr. Reinhardt: I share Mr. Palmer's approach to this particular question and I am glad to hear him say he did not want this witness's opinion on legal questions, because that was certainly the impression his question gave me, and that was the basis on which I object to this last question because it was designed, if I understand it correctly, to bring out the witness's opinion as to what would hap-
[fol. 2369] pen in the event a difference of opinion developed between the receivers and the State Auditor as to the desirability of a particular plan of reorganization. That, I think, is a question of law, and I don't think this witness should be asked about that, or, if Mr. Palmer wants to ask him about that, he should ask him so the witness understands what he is asking.

Mr. Palmer: Mr. Reinhardt and I are in perfect agreement. I don't intend to frame my question to bring out such a conclusion.

The Court: If you are agreed don't argue any further.

Mr. Palmer: Mr. Smith, you have told us it was your intention to form a plan. What I want is the fact whether or not you intended to have your plan suggest that it would, so far as possible, affect all of the various state funds and all of the contract holders in the various states as a joint jackpot or group of all the contract holders in all the funds. Is that question clear or not?

A. I believe I understand it. Our plan, of course, would take in as a group all of the assets of all of the funds in
[fol. 2370] all states, and that would be the basis for our plan. We also had discussed from time to time if we were not able to——

Q. Let me ask you a question——

Mr. Ray: Let him finish his answer, please.

Mr. Palmer: Go ahead.

A. And if we were not able to secure the cooperation of any state we knew that would affect materially any plan, and we would have to go back and build over it again. For instance, one state in question that we had talked about frequently, was Wisconsin, where they were liquidating the deposit. We knew that would affect materially Series B contract holders, for instance, because there was an excess of securities on deposit in that fund in that state, and there was an excess in some other funds and a de-

ficiency in others. Then we would have had to start all over by eliminating Wisconsin, and that would affect our securities in practically all the funds.

Q. So that, as well as having a general plan in mind which would affect all the states and all of the contract holders, you also were attempting to work towards some-
[fol. 2371] thing so that if any state or any group of contract holders would not co-operate with you, that you could still go along towards some plan of reorganization?

A. We knew it was a possibility that we might have that kind of situation arise and would have to adjust our plan to fit the situation.

Q. And you said all you had was the barest talk that you had to make a start towards these plans but had not been able to make any start towards formulating them? Is that right? . .

A. I think the only way a plan could be worked out——

Mr. Palmer: Read him my question and let him answer.

The Court: I believe he is trying to answer.

The Witness: My intentions were to answer the question, I believe before any plan could be worked out we would have to treat the situation as a whole, all the assets and all the liabilities.

Mr. Palmer: Will you read my question, please?

(The question was read.)

The Witness: Have I answered it?

[fol. 2372] Mr. Palmer: No.

The Court: I don't think you answered that.

The Witness: I don't understand the question.

Mr. Palmer: Let me rephrase it, that you had generally discussed that there should be a plan of reorganization, a broad plan which would include all of the states and all of the contract holders and all of the funds, and also the other possibilities that certain states and certain groups might not work with you, but outside of having that general talk and that broad idea, you had not yet been able at the time you were relieved as receivers, to formulate any plan leading toward that result? Isn't that true?

A. No, certainly not, because the State of Wisconsin had advised us that they would give us, until, I believe, June 30th to submit a plan of reorganization. As I recall off-

hand, it was June 30th. Of course, we were relieved on June 6th and never got to it.

Q. Mr. Smith, let me ask you this, had you either determined by discussion between you two as receivers or by discussion with your counsel whether or not a plan should be worked out which would treat each series as a separate [fol. 2373] entity or whether or not the entire groups should be treated as one entity regardless of series, or whether state lines and state deposits should govern? Had you discussed or decided upon that, or had a chance to discuss and decide on it with your counsel?

A. We had discussed it, but I don't recall having the advice of counsel as to what we could finally do.

Q. Had you discussed it, however, enough that you had reached any conclusion, or did you need legal advice to reach any conclusion?

A. No, we had not.

Q. In other words, everything you had done up to the time you were relieved was principally the collecting of the assets rather than any ultimate work on formulating something to do with them? Is that right?

A. Yes, we had spent a good deal of time in trying to corral the assets, and we had laid plans for an audit, as we felt we needed an audit to determine the exact status of each contract fund as of the date of our appointment.

Q. That was one definite plan that you had determined upon?

[fol. 2374] A. Yes.

Q. Had you had sufficient conferences with Auditor Sims to feel that he would co-operate with you in everything that you did that was legally correct?

A. I had discussed it personally with Mr. Sims a number of times—some notion of the plan—and he never gave me any idea that he would not co-operate. In the absence of having a definite plan worked out, however, I can't answer as to what he would have done about that.

Q. Were you in touch with the various officials of the states in which there were deposits?

A. You mean as receivers?

Q. Yes.

A. They had—different states had written us from time to time. We had, as receivers, never made a formal request for them to appoint ancillary receivers or receivers.

Q. I realize that. It is in evidence that Mr. Sims sent a telegram to them asking for that.

A. Yes, sir.

Q. My question is whether you were in touch with the proceedings, statutory or judicial, in other states, in which [fol. 2375] there — deposits of Fidelity.

A. We knew proceedings had been undertaken in other states and——

Q. And were you in touch with those who were in charge of those? Did you have correspondence, say with Wisconsin, the state officials there?

A. I think the counsel had correspondence with the State of Wisconsin.

Q. All right. Did you have corresponde-ce or a telephone call from the State of Ohio?

A. Yes. As a matter of fact, Mr. Lloyd came over to see us one day.

Q. Or the State of Missouri?

A. Mr. Godfrey came to Wheeling to see us.

Q. That is my question. Were you in touch with the various persons in different states in which there were deposits?

A. Those are the only three that I recall offhand.

Q. Those are the only three?

A. Yes.

Q. How about Pennsylvania?

A. Oh, one of the ancillary receivers from the Western [fol. 2376] District did come down to Wheeling to see us, too.

The Court: Was that an ancillary receivership?

A. I say ancillary. I believe at the last hearing I was disqualified on knowing what an ancillary receiver was, but in the petition of appointment over there they were called ancillary receivers.

The Court: All right.

Mr. Palmer:

Q. How about Maryland? Were you in touch with the State of Maryland?

A. No, I don't recall that.

Mr. Palmer: That is all.

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# Vol. III

## TRANSCRIPT OF RECORD

## Supreme Court of the United States

OCTOBER TERM, 1942

## No. 319

FIDELITY ASSURANCE ASSOCIATION, A CORPORATION, DEBTOR, AND CENTRAL TRUST COMPANY, TRUSTEE FOR FIDELITY ASSURANCE ASSOCIATION, PETITIONERS,

*vs.*

EDGAR B. SIMS, AUDITOR OF THE STATE OF WEST VIRGINIA, AND EX-OFFICIO INSURANCE COMMISSIONER OF THE STATE OF WEST VIRGINIA, ET AL.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT

PETITION FOR CERTIORARI FILED AUGUST 20, 1942.

CERTIORARI GRANTED OCTOBER 12, 1942.

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## VOL. III

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Cross-examination.

By Mr. Huwe:

Q. Mr. Smith, when Mr. Godfrey came to see you was it for the purpose of getting the securities out of Wheeling? Was that his purpose?

A. His first trip was designed to take possession of those securities, which we explained to him were under the jurisdiction of the state court, and then in turn we suggested that he go back and discuss it with the state officials and bring receivership proceedings to protect the contract holders.

[fol. 2377] Mr. Huwe: Your Honor, I am sorry I wasn't here at the beginning of the resumption. I would like to make just a short statement in reference to an answer to Mr. Dunifon's statement.

The Court: All right. I will permit you to do that. Go ahead.

Mr. Huwe: Mr. Rivers informed me that he had examined the law of Ohio and discovered that a contract holder should file a mandamus suit to compel the State Treasurer, combined with the Insurance Commissioner, to liquidate the deposit if the company was insolvent. The receivership proceedings in Kanawha Circuit Court in West Virginia had declared the company insolvent. Mr. Rivers learned of the receivership suit from the Insurance Commissioner or the Attorney General's office, and rather than duplicate law suits by filing a separate mandamus suit he thought he was doing a good turn by filing a cross petition in the injunction suit. However, he prepared the foundation for both a mandamus suit, which Mr. Dunifon has admitted is authorized by a creditor in the State of Ohio, and he used the same letter for an injunction suit, or rather cross [fol. 2378] petition in the injunction suit. I went along with him when he filed the cross petition in Columbus, although it was his case, and we were unaware on June 10th or 11th that the Federal Court had taken jurisdiction on June 6th. So was the Court unaware. We had not notified the Attorney General's office, although we were including the Treasurer in the cross petition, because of the rules of practice familiar to our own district and county, which were different with respect to notifying a prospective defendant

in an intervening cross petition. So we didn't give the other side notice. We filed the intervening cross petition and got our service on Mr. Smith and other people out of the state according to statute; and then we received a letter—I think Mr. Rivers received a letter—not from the Court, but from the Attorney General—although I am not sure about that first letter—stating that there had been some Federal proceedings enjoining any state procedure. By the time we got up to Columbus on the matter the second order of June 10th explicitly clarified any doubt which we had originally raised with reference to whether it covered property of the debtor in the State of Ohio, because it [fol. 2379] named the deposits and named the various offices; so on the strength of that, and in addition to the fact that we had not given the Treasurer notice under the rules of the Franklin County Courts of Ohio, the Court said he was going to put on an order dismissing our cross petition. Mr. Rivers had laid the foundation, however, for a mandamus suit, which would have liquidated the deposit, a purely ministerial act on the part of the Insurance Commissioner; he had to follow the law once insolvency was established. So that, had the federal case not intervened, that suit would still probably be in progress and would have forced Mr. Lloyd to liquidate rather than co-operate with the West Virginia state receiver.

When this matter developed Mr. Rivers and I came in to try to find out the picture, and we intervened, still thinking that liquidation was proper, because we had been informed by a broadside from Columbus—whether it was the Attorney General or the Insurance Commissioner's office I don't recall—that Series D was insolvent in a small degree, as well as all series of contracts. When we got into the [fols. 2380-2381] hearing on August 4th and 5th and examined the exhibits of the trustee filed on August 5th, we discovered Series D solvent, Series B and Series C solvent, and Series A solvent under certain conditions. Of course, that was the factor which caused us to change our course of conduct with reference to wanting the company to be liquidated. Series B, especially, having over 50 per cent of all the contracts and all the assets and all the liabilities of the company, being solvent, it was our opinion that since the major per centage of contracts, liabilities and assets were in funds that were not insolvent, that there was a chance for the company to be reorganized; and we have

therefore followed that position ever since. That brings us up to date. If I am mistaken in any detail I will be glad to have Mr. Donifon correct my statement.

. . . . . .

[fol. 2382] Q. What were your relations with any other state, whether receiver or state official with whom you had contact?

A. Mr. Lloyd, from Ohio, came over, and he had already been appointed receiver for the assets other than the deposit, and we told him we hoped that nothing would happen over there that might disrupt our plan to reorganize the company—What other states? There were three states.

The Court: Pennsylvania.

A. Oh, Pennsylvania. The receivers for the Western District of Pennsylvania came down. Of course, they had no assets, as the deposit in Pennsylvania had been were not much concerned with those fellows.

Mr. Reinhardt: You testified that you were the choice of Mr. Sims as receiver. Who chose Mr. Thomas?

A. I don't know.

Mr. Palmer: I believe Mr. Sims testified about that. If Mr. Sims knows any more about it I will be glad to have it. [fols. 2383-2386] Mr. Sims testified that he personally picked Mr. Isaiah Smith, but after a conference with Mr. Arthur Koontz, who believed that on behalf of the company there should be two, one of them a legal representative, and it being represented to Mr. Sims that Mr. Ross Thomas was very familiar with the legal structure of it, he appointed him as well, and that he had later found out that the representations as to the legal knowledge of Mr. Thomas concerning it had been well taken.

The Court: That is about what Mr. Sims said.

. . . . . .

[fol. 2387] Q. Mr. Smith, I understand that in your opinion the proper basis for any plan of reorganization would have included all of the contract holders and all of the assets in all of the states.

A. Most certainly. I would think any plan we would work out we would have to take into account all of the [fol. 2388] assets and all the liabilities before starting to

work on working out any constructive plan of reorganization.

Q. And your position as state court receiver was such that after you worked out such a plan, if any state refused to co-operate with the plan you had no way to compel it to.

A. As a layman I would say that was my notion of the law, that we had no jurisdiction beyond the bonds of West Virginia.

Q. And assuming that you had no way to compel one of the states other than West Virginia to co-operate with the plan, and some other state did not co-operate, what would that failure to co-operate do to the plan?

Mr. Palmer: If your Honor please, I think I understand what Mr. Ray is asking, and when he speaks of states refusing and so forth, there is a distinction between contract holders within the state who might or might not voluntarily go along with the plan and state statutory officials who might refuse to co-operate officially with any plan but would permit their contract holders to, and I believe that Mr. Ray could be helpful in making his question a little more clear [fol. 2389] in reference to just what he has in mind in that regard.

Mr. Ray: What I meant by the states is those persons, either state officials or officials appointed by courts, who had charge of the deposits of the company in those states.

The Witness: That is right. Now let me have the question.

(The question was read.)

A. Of course, it would depend on the size of the deposit in the states and the liabilities that might be in the state that refused to co-operate. Take a state with large deposits, such as Wisconsin or Illinois, that would affect materially, of course, and would tear your plan completely down and you would have to build another plan excluding from it the assets in that particular state.

Q. Will you be a bit more specific and tear it down?

A. Well, let's assume that the assets of the company—I am using figures just for the purpose of illustration—supposing the assets of the company were valued at $23,000,000 and that the liabilities of the company were $25,000,000. [fols. 2390-2409] The State of Illinois, that there is three and one-half million liabilities with three million dollars in de-

posits. In the case of a state of that size, if it failed to cooperate, that would mean that you would have to eliminate from your assets $3,000,000 and have to eliminate from your liabilities $3,500,000 and build your plan over after taking the assets and liabilities. I may not have made that very clear; it is clear to my mind.

Q. What I am trying to get at, would it not affect each series of contracts?

A. Most certainly it would.

Q. What do you mean by that?

A. Well, in some of the states the deposits of securities is far in excess in a given fund of the liabilities. On the other hand, a deposit is far short of the liabilities. So that would throw you completely off on your theory of trying to organize by plan.

* * * * * * *

[fol. 2410] Q. About these expenses of operation, what about that?

A. Mr. Farmer, any estimate of expenses that we could make now anticipating a year's expenses would be—would have to be qualified in so many ways it might be a very wild estimate. I could give some motion on the basis of the present operation and the payroll.

Q. That is right. Tell us what the payroll is, what it will run annually on the present basis.

A. Present basis about $84,000, about $7,000 a month.

Q. On the present basis the annual payroll would be about $84,000?

A. That is right.

Q. That is exclusive of any commissions to the trustee or counsel fee?

A. That is right.

Q. Then name the other principal expenses that would be incurred?

A. Well, your supplies and the—I don't know how many general notices we might have to give to creditors. I know [fol. 2411] when they send out 80,000 letters——

Q. Let's leave out notices to creditors.

A. Your supplies, I wouldn't hazard a guess as to what they would cost. Taxes on real estate, and then, contingent upon the outcome of this present suit in which we are appealing the income tax levy, it would be pretty hard to guess the income tax.

Q. What are the taxes on the home office building?

A. And insurance. I don't know.

Q. You estimated here last time that all those expenses in that category, with the salaries on the present basis, would amount to between $125,000 and $150,000 a year, didn't you?

A. Yes, as an estimate I would say.

. . . . . .

[fol. 2412] The Court: I believe, in view of some testimony that was adduced or attempted to be adduced with reference to whether or not the attitude of state officials was a vital element in considering whether a plan could be devised, the Court would like to have statements on the record from representatives of those state officials, if they care to [fol. 2413] make them, as to whether or not they wish to cooperate with any plan that might be evolved in the state court receivership which would have as its purpose the reorganization of this company.

Mr. Palmer: If your Honor please, I have been the spokesman in this case on behalf of Mr. Sims, and from conversations I have had with him and the conferences with him and with Attorney General Meadows of the State of West Virginia, the attitude of Mr. Sims was that he would lend all possible aid in every way to a reorganization of Fidelity in the state court; that he felt—that he himself felt—if I could put it that way—that the state court receivers were part of his legal machinery to perform a reorganization; that he had attempted to work with the company in all possible ways to achieve a reorganization prior to instituting his suit; that he sent telegrams to all of the statutory officials in other states asking that they bring proceedings to hold in statu quo the assets of Fidelity and to protect them against suits or wastage, and that that was done in every state to which he wired after bringing his proceedings here, and that he himself felt that every at- [fol. 2414] tempt should be made in the state court to rehabilitate Fidelity as an insurance company, and that as to states outside of West Virginia, and as to contract holders both inside and outside of West Virginia, if should be a voluntary matter, and if a great enough percentage should agree to a reorganization that they who voluntarily agreed to it should be permitted to and those who did not choose to be reorganized should be permitted to liquidate;

that that should be a matter of individual concern to each policyholder without coercion by state officials or anyone else, and that those who desired that reorganization that everything should be done to attempt to form from the assets of Fidelity applicable to them some sort of insurance company, which would be a mutual company owned by those reorganized policyholders. Mr. Sims worked in every way toward that ultimate end. He felt that the state court proceedings, such as he brought, was a step that he was taking towards that end. If it were entirely impossible to get any appreciable number to agree, that then, of course, the question of liquidation would arise.

The Court: Now we have a statement of the attitude of [fol. 2415] Mr. Sims made on the record by Mr. Palmer, who, while he does not technically represent Mr. Sims here, I assume is speaking at least with the quasi authority of Mr. Sims.

Mr. Palmer: I think that would be a good expression, your Honor.

The Court: Now, how about the other states?

[fol. 2416] Mr. Schurr: Your Honor, I might say I appear here on behalf of Mr. Godfrey, Receiver in Missouri. I can't necessarily speak for Mr. Maloney, because I did not anticipate a question of this kind arising at the hearing here today; but judging from the conversations we have had with Mr. Maloney, the Commissioner of Securities of Missouri, he has one duty to perform, and that is the protection of the Missouri contract-holders. If reorganization is effected, any contract-holder that desires to go along with that reorganization, it is not for Mr. Maloney—and I am satisfied I can say this for him—he will not attempt to interfere with the desires of that contract-holder.

The Court: How could he, if he wanted to?

Mr. Schurr: That is right, he couldn't, but I mean by trying to convey to the contract-holder that reorganization should not be effected, such as Mr. Smith testified when I asked him what he meant by cooperation.

The Court: Do you think that means cooperation by Mr. Maloney in the plan?

Mr. Schurr: What?

The Court: What you have just stated.

[fol. 2417] Mr. Schurr: You mean let the contract-holder decide, without any statement whatever that might influence him?

The Court: Yes.

Mr. Schurr: I do. And also I think if reorganization is effected, and the reorganized company could comply with the regulations of the State of Missouri, I am satisfied Mr. Maloney would let them continue to do business in the State. Also he has a duty where certain contract-holders may not desire reorganization, to see that they are paid in accordance with the arrangement and deposit made with the State of Missouri to secure the payment of that contract-holder.

The Court: You do not mean to imply, though, that if reorganization is effected in the Federal Court instead of the State Court, Mr. Maloney would have any different attitude, do you?

Mr. Schurr: I don't think, your Honor, Mr. Maloney is particularly concerned about courts. I do say this, in the face of the turn-over order that was originally issued, naturally he became alarmed, because he was afraid deposits may be taken away that were placed there to protect Missouri creditors. Also I think there is great doubt in the [fol. 2418] minds of not only Mr. Maloney but others that there might be a very serious question of obtaining the necessary consent of the contract-holders in order to effect reorganization in the Federal Court, which would ultimately result in liquidation.

The Court: Then the extent to which the State of Missouri or Mr. Maloney is willing to cooperate is simply to refrain from saying to any contract-holders that they ought not to participate in the plan?

Mr. Schurr: Refrain from advising the contract-holder one way or the other, and seeing that the contract-holder in Missouri is finally protected as he has been protected in the past.

The Court: Any other statements?

Mr. Lauritzen: I think I might make a brief statement, your Honor, on the same conditions as Mr. Palmer, it being understood that the Banking Commission of Wisconsin is an administrative body consisting of three members, and that they have discretionary powers in these matters, which, of course, are beyond my control or that of any counsel representing them. However, I think I can fairly express [fol. 2419] the attitude of the Banking Commission in this matter as it stands since the commencement of proceedings in the West Virginia state court.

Fidelity has for a long time been under very strict surveillance of the authorities in Wisconsin. They conducted a rather extensive investigation of the company in 1938, and finally, after receiving assurances of one kind and another, the chief assurance being from Fidelity and from its counsel that the Wisconsin Trust Law was absolutely inviolate and that the company so considered it the State of Wisconsin let them go, so they ran from 1938 till early in 1941, when these present proceedings were instituted.

When we got the wire from Mr. Sims down here, of course it became obvious to Wisconsin that something had to be done, and promptly. We took the action that we believed our statutes contemplated, going into the circuit Court of Dane County and also giving notice to the officers and directors of Fidelity that the Banking Commission had taken possession of their Wisconsin assets pursuant to the terms of Chapter 215, which is the Building and Loan law of Wisconsin. It should be understood that in Wisconsin [fol. 2420] Fidelity is regarded as an investment association, but is subjected to the statutes relative to building and loan associations insofar as such statutes can be made applicable to this concern.

We then had conferences with Fidelity's counsel, who had been the counsel for some years out there, and also purported to act for the state court receivers after their appointment here, and an acceptable plan was agreed upon. We analyzed the statutes and——

The Court: You mean a plan of reorganization?

Mr. Lauritzen: No, a plan of procedure——

The Court: I am asking now the attitude of Wisconsin toward a plan of reorganization by the receivers of the Circuit Court of Kanawha County. That is all I am interested in your statement on the record now.

Mr. Lauritzen: I am leading to that.

The Court: Well, I beg your pardon. I didn't know you were.

Mr. Lauritzen: Let me say that we then instituted those proceedings, seeking, of course, to operate within the laws of Wisconsin and to institute such proceedings as were authorized under our statutes. Then they represented to us that they were desirous of reorganizing. Discussions [fol. 2421] were had with the Circuit Court of Dane County, the three members of the Banking Commission, Mr. Harlan

Justice came out to Madison, Mr. Goldsmith came out, who was of Koontz & Koontz, also counsel for the receivers here, and we told them that we recognized that under the building and loan liquidation statute that we proceeded under that there was definitely a provision for reinstatement. However, the court out there and the Banking Commission also recognized that something should be done to safeguard and freeze the interests of Wisconsin contract holders. At the then market value they were protected to the full extent of their cash surrender value; and the Court reasoned thus. He said, "It may well be that something can be worked out acceptable to contract holders and to the Banking Commission of Wisconsin, but can I sit here and while such things are being worked out, in view of the international situation and other things, affecting the securities market—sit here and see those securities decline in value? If they double in value Wisconsin people are not helped one penny, whereas if they decrease in value Wisconsin people lose just that much"——

[fol. 2422] The Court: Mr. Lauritzen, before you go ahead, what the Court is driving at—maybe you don't just get it—but there is a provision that will require me to decide some time here in passing on the question that is now before me whether or not there is a proceeding pending which would properly safeguard the interests of all creditors and others interested in this company. Now, in order for me to determine that I have asked this question as to what is the official attitude of these various states towards the reorganization plan of the receivers of the Circuit Court of Kanawha County, where that is pending. It seems to me that the attitude of the states toward their own contract holders would not help me a bit in the world. What I must know is, what is the attitude of the states towards a general, comprehensive plan, not with respect to protecting their own contract holders, but with respect to participating in a reorganization plan which would be comprehensive and involve the whole structure of this company? Now, what is the attitude of Wisconsin towards that? If you can clear that up, all right.

Mr. Palmer: If your Honor please, might I interrupt [fol. 2423] a minute? I was going to suggest this. I have just spoken to the gentlemen from Maryland and one from Ohio, and both of them say that they are not prepared,

as attorneys, to answer the Court's question; and I presume they would like to receive advice on that from the proper state officials, and I was going to suggest it might be a good idea to give time to them to contact their proper state officials, as I would like to contact Mr. Sims, and get that officially for the Court for the purpose the Court has asked. We understand the Court is asking what would be the attitude of each state as to the reorganization plans i the Circuit Court of Kanawha County.

The Court: Not what will it be, but what is it?

Mr. Palmer: That is right. And I suggest that we do get in touch with the proper person whom we represent, actually or quasi, and get their attitude and put it into the record.

Mr. Huwe: Your Honor, do we have to go to that trouble? These gentlemen have been in here for three weeks on the basis of some attitude of their particular client, and I don't see why they are not prepared to stand up now and say [fol. 2424] what their attitude is and what their clients' attitude is.

The Court: I am not going to require them to do it now, if they don't want to do it; and I beg Mr. Lauritzen's pardon for this interruption of his statement. If you want to, finish your statement.

Mr. Lauritzen: I think I understand more fully what the Court had in mind with respect to a West Virginia state court reorganization. We, at the outset of these proceedings declined to have any proceedings in Wisconsin that would be ancillary to the West Virginia proceedings. The only kind of a reorganization we recognized was at all possible was a reorganization of this company by us as a Wisconsin concern, leaving all the assets there and supplying capital in some manner or other, with a complete severance from any of the rest of Fidelity—that is, to have a separate entity out in Wisconsin. That was administratively discussed; it was discussed by Mr. Fleming and Mr. Messick when they came there, and they seemed to feel that that represented an enlightened attitude and to feel that we had given more constructive thought to it, [fol. 2425] and so expressed themselves; but as to any reorganization, whether it be in West Virginia or in the Federal Court, which would look to the destruction either of the authority of the State of Wisconsin over these

companies or the destruction of contract rights of contract holders in those deposits in Wisconsin, the Commission would not agree to it, and that is generally their position.

The Court: All right. I think we will take a recess. If there are any other statements that are short——

Mr. Farmer: Your Honor, I can only express my personal views about it.

The Court: You represent contract holders?

Mr. Farmer: Yes.

The Court: Then I am not interested in that at this time. Of course, your views would be considered and given their proper weight, but now I am asking about the attitude of the states.

Mr. Farmer: I just didn't want to be in the attitude of sitting mute.

Mr. Gray: I want to say briefly, your Honor, that the Securities Act of Illinois does not make provision broad [fol. 2426] enough, but to partly answer that question, it does give the authority to the Secretary of State, in order to preserve as far as possible the rights and interests of contract holders to liquidate such securities on deposit in that state by entering into contracts with any insurer or persons able to buy such securities in whole or in part.

Of course, the primary purpose of our officers out there is to protect their official bonds and to cooperate with anything which tends to carry out this Securities Law and protect their contract holders.

The Court: Can you tell me what the attitude of the State of Illinois is as to whether or not they would participate in a plan developed and evolved by the receivers appointed by the Circuit Court of Kanawha County, which would be a comprehensive plan affecting the whole structure of the company and involving a reorganization?

Mr. Gray: Well, as to the fact that it was in Kanawha County, I can see nothing objectionable about that. It would depend largely, I presume, on the plan and the effect it would have on the requirements on them as officers [fol. 2427] and the general courtesy which the contract holders would require. The fact that it was Kanawha County or whatever place——

The Court: That is just about equivalent to saying you don't know.

Mr. Gray: That is right. I am sorry I can't be more finite.

The Court: Well, we will go ahead and recess now until twenty minutes till four.

(At 3:31 P. M., a recess was taken until 3:40 P. M.)

After Recess

3:40 P. M.

The Court: I see the representatives of the State of Ohio and the State of Maryland are here. May I have some expression from them in regard to the question the Court asked?

Mr. Brown: May it please the Court, Mr. Eney and I have appeared specially for the purpose of filing a motion, which was argued the last day we were here. I have never talked to the Insurance Commissioner of Maryland relative to the subject to which your inquiry is addressed. I don't know the answer. If the Court desires me to con- [fol. 2428] tact him and find out, I shall be pleased to do so.

The Court: I will leave that to you, whether you wish to do it or not, but at present you don't know, then?

Mr. Brown: I don't know. I know things are held in statu quo in Maryland.

The Court: You are Assistant Attorney General?

Mr. Brown: No, Mr. Eney and I have been appointed as special counsel for the Insurance Commissioner of Maryland.

Mr. Dunifon: If the Court please, I think it would be improper for me to express any opinion of the Supervisor of Bond Investment Companies in view of the fact that he is not a party in this case and has filed no pleadings in this case. It might be of interest to the Court, however, that contrary to an opinion expressed this morning, or right after lunch, that the Superintendent of Insurance of Ohio, or Supervisor of Bond Investment Companies, has no discretion but to liquidate, the fact is that the Superintendent of Insurance has on numerous occasions in the past permitted statutory deposits to be freed to relieve insurance companies as part of the assets of a defunct company, after a [fol. 2429] reinsurance agreement had been concluded, and similar statutes have applied it to investment companies, so I think it only fair to say that the attitude of the official in charge of this type of company in Ohio, although he is

not in this case, can be judged by his past performance, in that he has co-operated in reorganizing insurance companies on numerous occasions.

The Court: You don't know what the attitude of the State of Ohio is as to whether the officials of that state would participate in a reorganization plan proposed, evolved or formulated by receivers of the Circuit Court of Kanawha County, West Virginia?

Mr. Dunifon: Would you care for my personal view on that, sir?

The Court: No, I just want to know whether you know about the attitude of your state.

Mr. Dunifon: Very frankly, sir, the matter of reorganization had not proceeded to any such stage that we had the feeling in Ohio that state court receivers would be able to accomplish reorganization. I accompanied Mr. White to Wheeling on that occasion that he met with the state court receiver, and we returned to Columbus with the definite [fol. 2430] thought in mind that no particular progress had been made with reference to the reorganization. I am not critical of the fact that the state court receivers did not have that information, but that was the sole purpose of our visit. So far as legal advice to the state officers in Ohio that would have charge of either co-operating or assisting in working out a reorganization in Ohio, I would say that they would be advised to co-operate in a reorganization plan that salvaged more for the contract holders in Ohio than they would otherwise receive under a liquidation, whether that be in state court or federal court.

The Court: It was your present opinion, as I understand it, that no progress had been made on any such reorganization plan?

Mr. Dunifon: That was our inclination, yes, sir—our opinion.

Mr. Palmer: If your Honor please, in view of the Court's rephrasing the question, and having in mind I think Section 146, sub-section 3 or 4——

The Court: Sub-section 4.

Mr. Palmer: You have stated it that "A prior proceeding [fol. 2431] is pending in any court and it appears that the interests of creditors and stockholders would be best subserved in such prior proceeding." I am wondering if the Court's question should not be corrected as of June 6th,

which is the time the petition in this Court was filed, and whether at that time it was in good faith, because at that time a prior proceeding was pending in which the interests would be best subserved. Now, of course, it might be that this proceeding which has gone on for some time since June 6th, would continue sometime in the future and that from time to time the answer to the Court's question as to what is now the opinion of the states as to whether the Circuit Court officials of Kanawha could form a reorganization plan might change, so I think the Court's question should be directed to the day mentioned, whether there was at that time a proceeding then pending which could have subserved and so forth. I am suggesting that to the Court because I realize——

The Court: I think you are right about that, Mr. Palmer, and I believe that the answers have indicated that there has been no change in attitude. If otherwise, I would like for [fol. 2432] you gentlemen to state it now.

Mr. Palmer: I think I might suggest to the Court that Mr. Sims' answer is on the record to the effect that he did not believe a face amount securities company could be reorganized, and that so long as certain persons who had been connected with the old company had anything to do with the new company he would do all in his power not to permit it to serve in the State of West Virginia, and that answer should be included. I would rather his answers would speak directly for themselves than my interpretation of them.

The Court: All right. Now let's go ahead with the testimony.

Mr. Palmer: If you- Honor please, I have here a Senate Committee print of an Investigation of Concentration of Economic Power, Temporary National Economic Committee, Monograph No. 28, Study of Legal Reserve Life Insurance Companies, a study made under the auspices of the Securities and Exchange Commission for the Temporary National Economic Committee, Seventy-Sixth Congress, Third Session, Pursuant to public resolution No. 113 (Seventy-fifth Congress), authorizing and directing a select [fols. 2433-2443] committee to make a full and complete study and investigation with respect to the concentration of economic power in, and financial control over, production and distribution of goods and services. This report is made to Senator Joseph C. O'Mahoney, Chairman of the

Temporary National Economic Committee, the monograph having been written by Gerhard A. Gesell, Special Counsel of the Insurance Section of the SEC, and Ernest J. Howe, Chief Financial Adviser, Insurance Section, Securities and Exchange Commission, and being based, with footnotes showing where it is so based, upon a full and complete public hearing on the matter.

(There was a discussion off the record.)

Mr. Palmer: May I state on the record that the particular parts which I think are relevant are pages 96 to 101; then Chapter 10 on "Company Retirements—Reinsurance and Failures"; Chapter 13, "Classes and Types of Life Insurance Sold"; Chapter 14, "Policy Terminations"; Chapter 15, "Agency Practices"; Chapter 20, Part B, "Annuities"; Chapter 21, "Assets and Investment Practices"; B "Cash," C "Bonds," D "General Investment Considerations."

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[fol. 2444] Harlan Justice called as a witness for the state court receivers, having been duly sworn, testified as follows:

[fol. 2445] Direct examination.

By Mr. Palmer:

Q. Tell the Court your name, please.
A. Harlan Justice.
Q. Where do you live?
A. Charleston, West Virginia.
Q. What is your occupation?
A. I am Deputy Insurance Commissioner, State Auditor's office.
Q. How long have you occupied that position?
A. Over eight years.
Q. And who has been the auditor under whom you have been employed?
A. Edgar B. Sims.
Q. Have you been in office during the entire time that Mr. Sims has been in office?
A. Yes, sir.

Q. Have you from time to time advised with Mr. Sims about Fidelity Investment company?

A. Yes, sir.

Q. Were you at a meeting of the various securities commissioners of the various states of the United States held [fol. 2446] in Chicago in June of 1941?

A. Yes, sir.

Q. Will you give the Court an indication or idea of what states were represented and, not the name of the person, but the title of the person who was present at that meeting?

A. Well, there were representatives from Indiana and Illinois, Wisconsin, Ohio, Maryland. I don't know—there must have been ten states represented there by somebody from the securities department or attorney general's office or insurance department.

Q. Had there been a meeting just prior to that time in the City of Detroit of the Association of Insurance Commissioners, or whatever the name of it is?

A. There is a National Association of Insurance Commissioners.

Q. And had they had a meeting in the City of Detroit just prior to that time?

A. Yes, sir.

Q. Tell the Court whether or not at that meeting in Detroit it was learned, or shortly thereafter learned, that there had been a federal court proceeding instituted concerning [fol. 2447] Fidelity, and whether or not the Chicago meeting was the outgrowth of that with the states who were interested in Fidelity being there represented to a large extent.

A. Mr. Sims and I learned about this meeting of these state representatives in Chicago while we were in Detroit, and we called the office here to see if Mr. Brown had received an invitation or request to be present and so on, which he said he had not received, and the Auditor had to leave and come back to Charleston, and he asked me to attend that meeting.

Q. Was that a meeting of officials of the states who were interested in Fidelity?

A. Yes, sir.

Q. Tell the Court whether, at that meeting, appeared Mr. James Fleming?

A. Yes, sir.

Q. At the meeting in Chicago?

A. Yes, sir.

Q. That is the Mr. James Fleming who is here—who is not here today, but has been here present representing the debtor, Fidelity Assurance Association?

[fol. 2448] A. I understand he is the same man, yes, sir.

Q. Will you tell the Court just what Mr. Fleming informed you gentlemen representing the various states at that meeting?

Mr. Ray: I object to that, your Honor.

The Court: On what ground?

Mr. Ray: Well, that certainly would be hearsay. We can get Mr. Fleming here.

Mr. Palmer: We are asking him what he heard Mr. Fleming say. There is no hearsay about that.

The Court: I overrule the objection.

Mr. Palmer: Go ahead. Repeat the conversation as nearly as you can.

A. Well, this meeting was called, I understand, by Mr. Jarecki.

Mr. T. C. Townsend: I can't hear you.

A. (Continuing.) He was chairman of this meeting, and it was called for the purpose, my understanding was, to discuss this situation that had arisen with these various state deposits after this federal procedure had been begun, and the meeting had been in session just a short time when [fol. 2449] Mr. Fleming made an appearance, and told these men that he had been brought into this matter by the stockholders, particularly Mr. Marshall; and Mr. Marshall and his family were the principal stockholders in the company and it had been in their family for many years, and that under the states' procedure that it was very apparent that the matter was headed direct for liquidation, and that they didn't want to see the company liquidated because it would be a great loss to most of the people who had their money in it, and that they had brought him into the case and this federal procedure had been brought, and that he also stated that—that he and Mr. Messick had been retained for the purpose of working out a reorganization plan.

Mr. Palmer: Retained by whom?

A. By the trustee.

Q. All right; go ahead.

A. And that they were going to proceed to work out such a plan. Well, there was quite a number of people shot a lot of questions at him. They were particularly interested in these deposits, and they understood that there had been a court order entered which required the states to turn over these deposits, and they asked Mr. Fleming [fol. 2450] if he would enter an order—or prepare an order and present it to the courts waiving that in some way. I didn't understand—I am not a lawyer and I didn't understand the exact purpose of it. Well, the way I got it he didn't agree to do that, but he did agree, before he left the meeting, to try to work out some informal conference with these various state representatives and the Court—said he would try to do that.

Q. Was there anything asked him concerning his attorney's fee in the federal court proceedings and his employment by the trustee?

A. Yes, somebody popped him with a question about fees. He said well, that the State of West Virginia was not a wealthy state, and he thought, that all things being taken into consideration, that the fees would be reasonable.

Q. Did he say whether or not he expected the federal court to set his fee for that work for the trustee or whether the trustee would pay him; or did he mention that?

A. I don't recall that he mentioned that.

Q. What was the date of this meeting?

[fols. 2451-2453] A. It was Friday the 13th.

Q. Of what month?

A. June.

Q. And where was it held?

A. In the LaSalle Hotel.

Q. In what city and state?

A. Chicago.

Q. Chicago, Illinois?

A. Yes.

Q. How long was Mr. Fleming there present with you?

A. Well, I should say about an hour—an hour or so.

Q. Was Mr. Messick then present?

A. I didn't see him, no, sir.

[fol. 2454] Mr. Justice, I don't want to lead you, but I do want to get further information about that meeting in

Chicago. Mr. Fleming appeared at that meeting and explained how he originally became interested in Fidelity? Is that right?

A. Yes, sir.

[fol. 2455] Q. And then he told you that at that time he and Mr. Messick had been employed by the trustee of Fidelity.

Mr. Ray: Your Honor, I am going to object to this type of direct examination.

The Court: He has already testified about those things. Why ask them again?

Mr. Palmer: I am leading up to another subject.

The Court: I don't think you have to do it by repeating what has already been testified to.

Mr. Palmer: All right.

Q. Now, I want to ask you this: is there any doubt at all as to your memory of Mr. Fleming's statement concerning his connection with the trustee?

A. No, sir.

Q. Tell us in substance whether the conversation dealt with matters relating to Fidelity and what would have to be done by virtue of the Federal Court proceeding, and if you can detail as much of those conversations as you can remember.

A. Well, the major question, and the one that was discussed all around, was the status of these deposits——

The Court: Which conversation are you talking about?

[fol. 2456] Mr. Palmer: Between Mr. Fleming and the gentlemen at this meeting at which Mr. Justice was present.

The Court: I will let you develop Mr. Fleming's statements so far as they relate to this particular question that you seem to be referring to; his employment by the trustee and so forth, but I think it would be improper to detail any conversations that took place among those representatives at that meeting. That would be so clearly hearsay——

Mr. Palmer: Oh, yes. I only meant the conversations between Mr. Fleming and any of those gentlemen.

The Court: Well, so far as they are pertinent.

Mr. Palmer: Yes. Go ahead.

A. Well, the major point that was on everybody's mind seemed like that was in this meeting was the status of these deposits that were held by the various states.

Q. Were they questioning Mr. Fleming about that?

A. Yes.

Q. And was he answering about it?

A. Well, they were more interested in trying to get him to agree to amend his—at least, to bring some papers into [fol. 2457] court amending the Court's order about the transfer of these deposits over to a trustee.

Q. Let me ask you this, to refresh your memory on it. Was anything said by Mr. Fleming as to his ability to reorganize a company, and did he give any examples of other company reorganizations in which he had taken part to indicate his ability?

A. Yes, he told this meeting that he had been connected in some way with the reorganization of some—Wayne Pump Company, I believe he called it, and seemed to point to that as having been a very successful reorganization.

Q. May I ask why he related his connection with that reorganization?

Mr. Ray: May it please your Honor, this is not relevant to this case. Mr. Fleming is not a party in interest.

The Court: It may have some bearing. I will overrule your objection. However, that particular question is objectionable. You are asking this witness why Fleming did that.

Mr. Palmer: Well, I meant was it in answer to a ques- [fols. 2458-2482] tion.

Q. Was there a question asked concerning Mr. Fleming's ability to help reorganize, or did he volunteer his explanation of his ability to reorganize?

A. He volunteered it.

Q. He volunteered it?

A. Yes, sir.

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[fol. 2483] FRED RISLEY called as a witness, having been duly sworn, testified as follows:

* * * * * * *

[fol. 2484] Q. What is your name?

A. Fred Risley.

Q. Where do you live, Mr. Risley?

A. At the present time at Pleasantville, New Jersey.

Q. What position do you hold with the Fidelity Assurance Association?

A. I was elected president in April, 1940.

Q. How long have you been connected with that company, Mr. Risley?

A. A little over seventeen years.

Q. Will you tell us what various positions you have held with the company?

A. I started in as a salesman in the Washington, D. C. office, was made associate manager of that office, and that was all in 1924. In February, 1925 I was elected secretary-treasurer and made my headquarters after that in Wheeling, and subsequently I was made vice-president and secretary and——

Q. Can you give us the date of that, please?

A. I would say 1927 or 1928, and then I was elected executive vice-president along the latter part of 1939, and [fol. 2485] president in April, 1940.

Q. When were you first elected to the board of directors of Fidelity, Mr. Risley?

A. I believe about 1927.

Q. And served continuously since that time?

A. No.

Q. For what interval were you not on the board?

A. I believe there were two intervals that broke up my continuous service. I do not remember the date.

Q. Could you give us approximately how long they were or when they were?

A. I believe one interval lasted nearly a year.

Q. Beg pardon?

A. I believe one interval lasted nearly a year and the other one—oh, probably eight or nine months.

Q. Are you a stockholder, either preferred or common, of Fidelity?

A. I hold both.

Q. And will you tell us how many shares of each you hold?

A. Three hundred and sixty-seven shares of common; I think about twelve shares of preferred.

[fols. 2486-2513] Q. How long have you been a stockholder of Fidelity?

A. Since 1925.

Q. Mr. Risley, as president of Fidelity, were you fairly familiar with all of the various details of Fidelity?

A. Well, as much as it was humanly possible to be, yes.

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[fol. 2514] Q. Do you know when Mr. Arthur Koontz first became associated with Fidelity?

A. It would only be a guess. I would say somewhere around 1928.

Q. I think the record will show it was around 1932. Again I am not attempting to state accurately on that.

A. Well, I don't know definitely.

Q. When did he first become active as an attorney in the affairs of the company?

A. I wouldn't be able to recall that.

[fol. 2515] Q. Isn't it a fact that he really became active in the affairs of the company to a major extent after the SEC suit was brought in Detroit in December, 1938?

A. I think that is a correct statement.

The Court: Who got him in, Mr. Risley?

A. I believe Mr. Marshall was instrumental in that.

Mr. Palmer:

Q. State whether or not you were familiar, and if so to what extent, with the activities of Mr. Koontz and his firm on working on the defense of that SEC suit in Detroit in 1938.

A. Well, I was with the legal staff in Washington day and night during that preparation.

Q. Did Mr. Koontz actively work on that matter?

A. He did.

Q. Were there any other members or associates of his firm who worked with him?

A. There was a Mr. Goldsmith and I believe Mr. Lambert. I am not sure whether he was in Washington or not; those days are rather confusing and hazy.

Q. Was Mr. Ross Thomas there?

A. I believe that—yes, I am pretty sure that he was there.

[fol. 2516] Q. Isn't it true that immediately after that suit was brought you, together with Mr. Koontz, Mr. John Marshall and others of Mr. Koontz's firm, worked practically day and night for some time in defense of that suit and getting ready to defend it?

A. Yes, sir; that is correct.

Q. And how long a time was it, would you estimate, that you worked so heavily?

A. Well, on the SEC case and the preparation of the registration forms for Fidelity and its subsidiary, I would say that he was very active on it for two or three months.

Q. During the period immediately following the institution of that suit, when you say that you were working practically day and night, were Mr. Koontz and his legal associates working with you practically day and night?

A. They were when they were with me, yes.

Q. And were they with you for any considerable extent of time at that time?

A. In Washington, yes.

Q. After that SEC suit in the early part of 1939, was [fol. 2517] there not a receivership proceeding brought against Fidelity in Wheeling?

A. That is correct.

Q. I believe that Mr. Tom Foulk is the local counsel, or was the local counsel, of Fidelity. Is that correct?

A. That is correct.

Q. And also at that time there was specially employed Mr. Austin V. Wood as local counsel?

A. That is right.

Q. And isn't it also true that Mr. Arthur Koontz and the other members of his firm of whom you have spoken came to Wheeling to participate in that suit?

A. They spent two or three weeks there, if I recall correctly.

Q. And isn't it true also that they spent some time in preparation before they went into Court?

A. Yes.

Q. And they worked with you and the other officers of Fidelity?

A. That is correct.

Q. And isn't it further true that after that suit was [fol. 2518] brought there was an appeal of it to the Fourth Circuit Court of Appeals?

A. There was an appeal, yes.

Q. And isn't it true that Mr. Koontz and his associates worked on that?

A. That is correct.

Q. And wasn't that considerable work that was done at that time?

A. I would think so.

Q. You were in constant touch with them during all this time and during all this work, weren't you?

A. I was.

Q. And they were working directly with you and other officers of the company?

A. That is correct.

Q. Up until this SEC suit, while they might have occasionally rendered sporadic services, the firm of Koontz & Koontz had not been actively working with Fidelity? Isn't that true?

A. That is correct.

Q. Mr. Tom Foulk and Mr. Marshall were the—if I may call them—local and general counsel—and from time to time [fol. 2519] other attorneys where it was necessary were called in to render services, including Koontz & Koontz? Isn't that true?

A. For legal cases, yes.

Q. On certain tax cases various other firms, like Mr. Marshall's firm in Washington, were called in?

A. Yes.

Q. Mr. Risley, in connection with preparing the registration for SEC, do you know or can you tell us how much work Koontz & Koontz and particularly Mr. Ross Thomas, did on that particular matter?

A. They prepared the entire registration statement, with the exception of the figures which were furnished by Haskins & Sells.

Q. Was that a voluminous report?

A. I would consider it quite so.

Q. About an inch and a half thick of printed pages?

A. About the thickness of a New York telephone book.

Q. And about the same size?

A. Well, it is longer.

Q. Can you tell us of your own knowledge the extent of time which it took to prepare that? In other words, [fol. 2520] was it a week or month or did it extend over a period of weeks or months or how long did it take, to your knowledge, from the start to the finish of preparing that?

A. My recollection would be about two and one-half to three months.

Q. And that was constant work?

A. From the time it was started until it was finished, yes, sir.

Q. Do you know whether Mr. Ross Thomas devoted practically all of his time to that one thing?

A. I was told that he had been assigned to that; I don't know myself.

Q. Did you work with him on occasions and give him information?

A. Yes.

Q. And was that frequent during that period?

A. Oh, four or five times I would say during that period.

The Court: Let me ask Mr. Risley the general tenor of that booklet which you say was a little larger than a New York telephone directory. Was it for the purpose of under-[fol. 2521] taking to pursuade the Securities and Exchange Commission that the Fidelity company was a good company and the kind of a company that should be permitted to do business, a solvent company and all that?

A. No, sir.

Q. What was it?

A. It was on the forms furnished or in the manner prescribed by the regulations of the Securities and Exchange Commission for registration of companies with them.

Q. I want to find out what the purpose of that booklet was.

A. It is a statement of the history of the company and financial statements for a period of three years.

Q. Why was it to be submitted?

A. That was part of the consent decree or arrangement made with the Securities and Exchange Commission at the time of their suit.

Q. I understand that, but I want to know what the purpose of that booklet was. What were you trying to convince somebody of by that book?

A. We were not trying to convince anyone of any thing, [fol. 2522] I think.

Q. Then why go to a lot of expense to prepare it?

Mr. Palmer: If your Honor please, that is a legal question.

The Court: Mr. Palmer, will you let me finish?

A. That is the regulations prescribed by the Securities and Exchange Commission. Any company registering with them must furnish a certain amount and type of information for the purpose of registering.

Q. Isn't it for the purpose of convincing the Securities and Exchange Commission that this company is a proper company to be permitted to sell its securities to the public?

A. Well, as I understand the Act, your Honor, the Securities and Exchange Commission doesn't pass on the quality of the registrant. They simply require you to furnish this factual information so that the reader can determine for himself whether or not he wishes to purchase the bond, stock, or other security that is being issued by the registrant company. It is purely a factual statement.

Q. Well, I understand that, but when you have furnished [fol. 2523] that, then the company has some interest in whether the Securities and Exchange Commission registers the company or not, hasn't it?

A. Well, as I say, as I understand the Act they have to register even an insolvent company if it applies for registration. I think what you have in mind, Judge, is the prospectus that is submitted to the public when they are solicited to purchase the securities of the company. That is a different document entirely from the registration papers. It contains various parts of the registration statement and refers to the balance of the registration statement for the part that is left out.

Q. Then there would be no purpose on the part of the company and there was no purpose on the part of the Fidelity company in submitting that large book, to have it show that the company was a desirable company to do business?

A. Well, it is simply to show the degree of solvency of the company for the past three years prior to the date of application for registration.

Q. Well, did it show that the company was solvent for the [fol. 2524] past three years?

A. Yes, sir, based on the sound market values—on the market basis there was a shortage, and that was the information that we were required to disclose to the public through the propectus.

Q. Was a prospectus submitted along with that large book?

A. One was prepared, yes, sir.

Q. Who prepared that?

A. Koontz & Koontz, with the assistance of the staff again.

Q. Was that through Mr. Thomas?

A. Yes, sir, Mr. Thomas, Mr. Goldsmith—they all worked on it I believe.

Q. Let me ask you the same question with reference to that prospectus that I asked you awhile ago with reference to the booklet. What was the purpose of that prospectus?

A. To be used in the solicitation of the sale of our contracts and to furnish the prospective purchaser with full information concerning the financial condition of the company.

[fol. 2525] Q. Was it one of the purposes of the prospectus to show that the company was a desirable company in which to invest and that it was a solvent company?

A. The purpose of the prospectus, your Honor, was simply to disclose the actual condition as it existed. You see, the amount of so-called selling material or sales talk was quite limited and is quite limited yet in any prospectus.

Q. Limited by whom?

A. The SEC regulations.

Q. Then it was the purpose of the prospectus so far as it could comply with the SEC regulations to present this company in the light that I have spoken of?

A. Yes, sir.

The Court: All right. Go ahead, Mr. Palmer.

Mr. Jaegerman: May I make one statement, your Honor, that this registration statement and prospectus were never filed with the Securities and Exchange Commission.

Mr. Palmer: Why not be fair and tell how many conferences and how long it went over? The Securities and Exchange Commissioners informally met and they couldn't [fol. 2526] agree among themselves.

Mr. Jaegerman: I don't think that is true, your Honor. I think I would have been told about it if it had been.

Mr. Palmer: Why don't you tell the Court the whole proceedings? I am going to ask the SEC, which I had earlier when I interrupted the Court—for which I beg the Court's pardon—to inform the Court of the law of 1933 as to why this had to be filed. It was a legal matter and it was necessary for Fidelity to file it. I would like for the gentlemen from the SEC to explain to the Court the legal reasons why it had to be filed. Mr. Risley only knows the general answers, of course.

The Court: I think that is apparent, the reason it had to be filed. The purpose of my question, as you probably

saw, was to find out just what the connection of the firm of Koontz & Koontz, and particularly Mr. Ross Thomas, was, and what attitude he took at that time toward the company, to see if that has any bearing on his suitability as a receiver, particularly.

Mr. Palmer: Will the gentlemen from the SEC be glad [fol. 2527] to put into the record the particular section of the law under which it was necessary to prepare and file a registration statement, the Act of 1933, I believe?

Mr. Reinhardt: Section 5.

Mr. Palmer: And might they also state in the record the difference that occurred in the Investment Companies Act of 1940, which may or may not have rendered the report unnecessary after it had been prepared, for the reason why it wasn't filed?

Mr. Reinhardt: If your Honor please, if it was necessary to file this report under the Act of 1933 it should have been filed in 1934, or at least long before—well, the end of 1933 or early in 1934, or at least a great deal sooner than it was filed—than it was prepared, I should say; it was never filed. I have here a photostatic copy of a letter signed by Mr. Marshall which I procured in response to a request from Mr. Farmer, which shows that as early as October 15, 1935, the question of the necessity for filing such a report was raised, and the company said that it claimed an exemption under sub-division 8 of Section 3-a of the Securities Act of 1933. Sub-division 8 provides——

[fol. 2528] The Court: I think that was read by Mr. Palmer already.

Mr. Reinhardt: I think that is true.

In 1940 the Investment Companies Act went into effect, and that contains entirely different provisions for filing documents with the Commission, and no forms have yet been formulated under that Act, except a form which consists of a notification of intention to register under that act, but no form of registration statement under the 1940 Act has been gotten up. Now, if there is anything Mr. Palmer——

Mr. Palmer: Yes, I would like to ask that what Mr. Risley has stated, that the consent decree provided that the company should file such a report, which it had not filed, as you say, in 1934, under the requirements of the Act, and that that is the reason the company was then preparing it.

Mr. Jaegerman: Your Honor, the consent decree, of course, speaks for itself. It is in evidence. There is noth-

ing in the decree that even mentions a registration statement. However, at the time that that complaint was filed [fol. 2529] in Detroit the company's attention was called to the fact that there wasn't a registration statement on file and that in the opinion of the Commission there should be a registration statement if the company intended to continue to sell its contracts; and the company voluntarily assumed the responsibility for having a registration statement on file with the Commission in the very near future.

Mr. Warner: Your Honor, perhaps I can from my own experience before the Securities and Exchange Commission answer the Court's question as to the purpose of a registration statement.

The Court: Mr. Warner, let's wait until after recess for that. We will recess Court until 11.30.

(At 11:20 A. M., a recess was taken until 11:30 A. M.)

After Recess

11:30 A. M.

Mr. Reinhardt: If the Court please, while we are on that subject of the registration statement, Mr. Risley can explain just why the registration statement was gotten up and why it was never filed, and I would like to ask him to do that.

The Court: All right. I interrupted Mr. Warner when I recessed the Court, and I just wanted to explain to Mr. [fol. 2530] Warner that the Court's question was not directed at the legal purpose of the statement, but the purpose the company itself had in mind. And now if Mr. Risley can further enlighten the Court on that, I would be glad for him to do it.

A. The purpose of preparing that form was to comply with the registration regulations and requirements of the Securities and Exchange Commission, and it was prepared solely with that thought in mind.

Mr. Reinhardt: May I ask, Mr. Risley, you referred to a period of two or three months during which you worked with counsel on this statement. When was that?

A. I would say that it began immediately after the conclusion of the bankruptcy proceedings in the federal court in Wheeling.

Q. You mean receivership proceedings?

A. Yes.

Q. When was that?

A. I believe it started about the first part of January—January 10th or 13th or somewhere along there.

Q. Those were the receivership proceedings?

A. Yes.

[fol. 2531] Q. I refer to the two or three months period. When did that start?

A. As far as I know it ran from somewheres around March up until some time in June.

Q. What year?

A. 1939.

Q. This conference that has been mentioned, when did that occur?

A. To the best of my recollection sometime in the summer of 1939, in July or June, somewhere along in there. I don't know exactly when it did occur.

Q. Who participated in that conference?

A. Mr. Koontz represented the association, and as I recall he told our board of directors that Mr. Lane——

Q. Who is Mr. Lane?

A. General counsel for the Securities and Exchange Commission, and Mr. Klein, who is I believe assistant counsel and some other person of the legal department of the Commission whose names I do not recall.

Q. Did he report on what happened at that conference?

A. He did.

Q. What was his report?

[fol. 2532] A. He reported that there was a difference of opinion concerning the applicability of the Bartlay Investment Trust Indenture Act if the association registered under the 1933 Act with the Securities and Exchange Commission, and he reported to us that the Commission—or this conference was divided as to whether or not it would have any effect on the association.

Q. And what was his recommendation?

A. And under those conditions he recommended that we not file the registration statement which we had prepared.

Q. Was anything further done about it?

A. Not to my knowledge.

The Court: Go ahead, Mr. Palmer.

Mr. Palmer: Let me ask you, Mr. Risley, if that conference of which you are speaking did not take place in the summer of 1940 rather than in the summer of 1939, and if the Investment Companies Act of 1940 had then either been passed or was in progress of being passed by Congress?

A. I believe that I have made a mistake on that year. I believe it was 1940, because there was not a gap of eighteen [fol. 2533] months; I am sure of that; so it must have been the summer of 1940.

Mr. Reinhardt: Wait a minute, Mr. Risley.

Mr. Palmer: Mr. Reinhardt, would you mind if I finished my examination and then cross-examine——

Mr. Reinhardt: I would, because this is a particular question that relates to the Securities and Exchange Commission, and I would like to get the facts in the first instance.

Mr. Palmer: Your Honor, I object to that, because——

The Court: I think Mr. Palmer ought to be permitted to go through, so I sustain the objection to the interruption.

Mr. Palmer:

Q. Mr. Risley, I was asking you about the preparation of this report, and the Court asked you some questions concerning it. Was it a report that you gathered the SEC required that the company file?

A. It was in accordance with the forms furnished by them.

Q. And it has been stated here by Mr. Jaegerman that either prior to or during the SEC suit in Detroit there was an informal conference at which the company voluntarily [fol. 2534] agreed, because of the insistence of the SEC, that they would furnish the report, even though perhaps they had not felt before that they should. Is that correct?

A. That is correct.

Q. In other words, there is a letter in evidence here by virtue of which the company believed it was exempted from filing this report. During the conference with the SEC in the latter part of 1938 or around the time the Detroit suit was filed—there was an agreement reached whereby the company voluntarily said that even though it had formerly objected, they would prepare and file the registration report?

A. Yes.

Q. And that was at the request and insistence of the SEC?

A. That was one of the conditions the association agreed to.

Q. And there was much work, both by you in getting the necessary information and by the firm of Koontz & Koontz in preparing the legal end of it, in order to get that report prepared? Is that correct?

[fol. 2535] A. That is right.

Q. Now, can you tell me whether or not there was filed under the 1940 Investment Companies Act the intention to file a registration that Mr. Reinhardt spoke about?

A. Yes, there was.

The Court: Excuse me, Mr. Palmer. Before you leave that, tell us what this Trust Indenture Act was, when it was passed.

Mr. Palmer: I believe the gentlemen from the SEC could do that.

Mr. Reinhardt: That was an act that was passed and became effective in 1939, your Honor, which contained provisions relating to the contents of a trust indenture, directed at things like exculpatory clauses and so on. I do not have a copy of that statute with me, I will be glad to provide a copy to the Court.

The Court: All I am interested in knowing is whether I have a correct understanding. On the passage of the Bartley Trust Indenture Act and consideration of that by Mr. Koontz, Mr. Koontz gave advice to the company that the registration forms which had been prepared not be filed. [fol. 2536] Was that the idea?

The Witness: That is correct, yes, sir.

The Court: They had already been prepared before the passage of the Bartley Act?

A. It was being prepared at the time the Bartley Act was passed by Congress.

Mr. Reinhardt: As I understand it, that is the testimony, your Honor. The question was whether the company would come within the provisions of the Bartley Act by filing this registration under the 1933 Act.

The Court: Of course, the question in the Court's mind was, if Mr. Koontz finally concluded that it ought not to be filed, why hadn't he reached that conclusion before he ever started the preparation of it. The witness says that the

explanation of that is that when the preparation was started the Bartley Act had not been passed, and after the passage of the Bartley Act Mr. Koontz considered that perhaps the filing of the registration would bring the company within the Bartley Act, and they didn't want to be brought within it and therefore recommended that it be not filed.

Mr. Palmer:

Q. Is that correct, Mr. Risley, what the Court has just [fol. 2537] stated?

A. Yes, as I understand it it is:

The Court: Now you may go ahead.

Mr. Palmer:

Q. In other words, further on that, by the regulations of the SEC and the laws of Congress it was thought and felt necessary by you and Koontz & Koontz, your attorneys, and so deemed necessary by the SEC, that you prepare and file this registration statement. Is that correct?

A. That is under the 1940 Investment Companies Act?

Mr. Palmer: No, 1933. Read the witness my question.

(The question was read.)

A. I might say that we agreed to file that registration statement, not that we believed it was proper to do so.

Q. But you agreed to at the insistence of the SEC?

A. We had a special meeting of the—I believe it was the executive committee—in the City of Washington, and furnished the Commission with a certified copy of the resolution in which we agreed to file a registration statement as soon as it was possible to prepare it.

Q. At whose office was that meeting held? Mr. John [fol. 2538] Marshall's?

A. I think that it was held in the Mayflower Hotel. I can't recall.

Q. Did Mr. Marshall or Mr. Tom Foulk participate in all these deliberations or a majority of them?

A. You mean with the Securities and Exchange Commission?

Q. Yes, or the deliberations about the action that was necessary for the Securities and Exchange Commission.

A. Mr. Foulk was in Wheeling, if I recall correctly; I

don't think he participated at all; and I am sure that Mr. Marshall did not.

Q. After this agreement and resolution, then you went ahead and began your work of preparing the statement. Is that correct?

A. After the bankruptcy proceedings were settled then we could start to work on that.

Q. And then by the time you had it finished, there had been a new Act of Congress passed, and a conference was had with certain gentlemen and counsel of the SEC concerning the effect of it on this registration if filed. Is that right?

[fol. 2539] A. That is right.

Q. And Mr. Koontz reported to the board of directors' meeting that the conference with the gentlemen from the SEC which you have related resulted in them, the SEC, disagreeing, some believing that it would be proper to file the registration and some believing it would not, and he came back and reported that to you and advised that under the circumstances it not be filed. Is that correct?

A. It wasn't the question of the propriety of filing; it was the question of whether or not the Bartley Act would become effective on the association if that registration statement was filed; and inasmuch as the company had definitely committed itself to file that registration statement, Mr. Koontz thought it was necessary and only proper that the thing should be submitted to the board of directors and they determine whether or not we should file.

Q. And what did the board of directors determine?

A. And they accepted his recommendation not to file the registration statement.

Q. That was after a full explanation by him of the [fol. 2540] law and the conferences and so forth? Is that correct?

A. That is right.

Q. So that the final action was by the board of directors?

A. Or the executive committee. I think it was the full board of directors; the minutes will show.

Q. What, if any, work was performed thereafter in getting ready this intention to file under the 1940 Act that you have talked about?

A. Koontz & Koontz prepared that, together with applications for each individual officer and director for waiver

under a certain section in the Act, I don't recall the number.

Q. And was that in pursuance of a meeting of the board of directors or the executive committee?

A. Yes, sir.

Q. And had the matter been fully discussed and the law given by Koontz & Koontz as counsel and the ultimate decision left either to the board of directors or the executive committee before it was undertaken?

A. Yes, there wasn't much discussion permitted for directors, because the Act required us to register—or rather [fol. 2541] to file an intention to register.

Q. Do you know how long Koontz & Koontz worked on that particular matter?

A. No, I do not recall.

Q. Would you give us an idea as to how frequently you or other officials of the company called upon or engaged the services of either Mr. Arthur Koontz or his firm from the filing of the SEC suit on up until the filing of the receivership suit in April of this year?

A. Well, it was a diminishing demand on Mr. Koontz and his firm's time. Immediately following the SEC case in 1938 he was called on, I would say, without any question, daily for advice.

Q. And nightly?

A. And nightly, yes, sir, and after that—after we became adjusted to the new order, so to speak, the demands on his time and Mr. Thomas's and Mr. Goldsmith's diminished.

Q. Now, Mr. Risley, after the passing of the Investment Companies Act of 1940 did you study the terms of that Act and confer with Mr. Foulk and Mr. Marshall and Mr. Koontz, the company's attorneys, about the effect of that [fol. 2542] Act upon the company?

A. I did.

Q. State whether or not from those conferences it became apparent to you that the company could not do business under that 1940 Investment Company Act.

A. It did.

Q. Is it true that the Investment Companies Act provided a loading of approximately $87.00 as the total amount for each contract, and you felt that it would be impossible to operate and sell at such a loading?

A. No, that is—wasn't the reason that we couldn't do business under the Investment Companies Act of 1940. It

was the reserve requirement which it was impossible for the association to meet.

Q. And didn't the cutting down of the loading have something to do with it as well in your considerations?

A. Well, we had conferences with our own staff officers on that proposition. Mr. Pulfer had succeeded Mr. Evans as the head of the sales department, and he felt that the association could operate at a profit on the loading as provided by the Investment Companies Act of 1940.

[fol. 2543] Q. Mr. Risley, isn't it a fact that early in this year, before receivership, at a conference you had with Mr. Sims and Mr. Harlan Justice, you told Mr. Sims that one of the principal troubles with the company was that they couldn't operate within their loading?

A. At that time that is absolutely correct, because we were bound by these leases for these offices, which were way beyond the means of the association, either with or without the Investment Companies Act to handle.

Q. The company never had been able to live within the loading on this contract? Isn't that true?

A. No, I wouldn't say so, Mr. Palmer. The agency division could not or did not live within their means.

Q. That is what I was speaking of in particular. The selling end of the company is what you call the agency end? Is that right?

A. That is right.

Q. The sales end had never been able to live or did not live within the loading provided for? Isn't that true?

A. I wouldn't want to go so far as to say they never had. [fol. 2544] I mean during the period while I was with them. I think that they did during that period live within their means, and of course, I don't know whether it has been brought out here in prior testimony or not, but the extravagance of the management of National Sales Agency was beyond any reason or any reasonable thought; it was beyond necessity in securing their sales force. I don't know whether that has been brought out here before or not.

Q. Well, if it has we would like to have you tell us more fully. The evidence, as I have already told you, discloses that of each dollar paid in by contract holders 18.9 cents was actually spent between 1927 and 1936 for selling. That was far and away above the loading for selling, wasn't it?

Mr. Ray: Your Honor, is this figure of 18.9 cents in evidence, that it was on every contract that this company issued, or is it——

The Court: I think Mr. Palmer is referring to a statement in a booklet which he has introduced which indicated that that was the average.

Mr. Ray: Average. Now, we have this series of contracts, and each one of them has a different loading for each [fol. 2545] one of these items, and for that reason I think this question is improper.

Mr. Jaegerman: Your Honor, those percentages were based upon the actual loading in the contract, and the percentage of that based against the amount paid in. Under the terms of the contracts, for instance, the first five or six payments might be 100 per cent loading, and that is why you get the 20 per cent in comparison with 7½ per cent loading that the contract might set forth. Those figures were based upon the total amount that was received, being mostly the amount paid in under the first five or six installments of the contract.

The Court: I think it ought not to be stated just as Mr. Palmer stated in his question, that the evidence is that a certain amount of money was spent out of each dollar for sales expenses. That was not exactly what the testimony disclosed.

Mr. Palmer: Let me, at the expense of the Court's dislike of reading a book, read one sentence.

The Court: All right.

Mr. Palmer: "The salesmen's commissions are paid if, as and when installment payments are collected. Total com- [fol. 2546] missions paid through the period 1927—1936 amounted to $9,308,000, a sum equal to 18.9 per cent of total installment payments, i.e. 18.9 cents of every dollar paid by certificate holders was required to meet commission payments." Perhaps I made it too broad, including all selling expenses; I should have said commission payments only.

The Court: That is for those particular years.

Mr. Palmer: Yes, I limited it to that.

The Court: All right.

Mr. Palmer: Mr. Risley, forgetting the cost of selling other than commissions, it is disclosed that 18.9 cents of every dollar paid in was paid back out in commissions to

the salesmen during the period stated. Isn't that figure far and away above the loading allowed under the 1940 Investment Companies Act?

A. Yes.

Q. What is the loading allowed under that—the total loading?

(No answer.)

Mr. Palmer: Can Mr. Reinhardt give us that?

Mr. Reinhardt: Seven per cent. Section 28 (a) (2) (A) [fol. 2547] of the Investment Companies Act——

Mr. Palmer: Seven per cent for what period of time—one year?

Mr. Reinhardt: (Continuing) Provides that "aggregate reserve payments shall amount to at least 93 per centum of the aggregate gross annual payments required to be made by the holder to obtain the maturity of the certificate. The company may at its option take as loading from the gross payment or payments for a certificate year, as and when made by the certificate holder, an amount or amounts equal in the aggregate for such year to not more than the excess, if any, of the gross payment or payments required to be made by the holder for such year, over and above the percentage of the gross annual payment required herein for such year for reserve purposes."

Now, the payment required for reserve purposes is set out in the previous part 28 (a) (2) (A), and that is that the reserves may be graduated according to certificate years so that the reserve payment or payments for the first certificate year shall amount to at least 50 per cent of the required annual payment for such year and the reserve [fol. 2548] payment or payments for each of the certificate years from the second to fifth inclusive shall amount to at least 93 per cent of each such year's required gross annual payment and for the sixth and each subsequent certificate year shall amount to at least 96 per cent of each such year's required gross annual payment.

As I gather, the effect is that the loading in the first year might run as high as 50 per cent, but over the entire life of the contract it can't run over 7 per cent.

Mr. Palmer: Am I mistaken in figuring the total loading to amount to approximately $87.00 on your $10.00 a month contract? In other words, you can take $60.00 out the first year?

Mr. Reinhardt: No, you take 93 per cent of the total amount paid in over all the years that the contract holder makes his payments. That has to be invested as the reserve behind the contract. Now, everything above the 93 per cent over the entire life of the payments is available for loading.

Mr. Palmer: That would leave 93 cents out of each dollar [fol. 2549] that must go into reserve?

Mr. Reinhardt: Right, and seven cents is available for loading.

The Court: In comparing the 18.9 which was used for expense during those years with the loading permitted under the new Act, an element must be taken into consideration in addition to what you have already spoken about, and that is whether or not the contracts were in their early stages or their later stages at the time.

Mr. Reinhardt: Because in the early stages under this Act up to 50 per cent is available for loading, whereas over the entire life of the payments it cannot be more than seven per cent.

The Court: That is right.

Mr. Farmer: If the Court please, I don't follow your Honor on that. This Investment Companies Act contains this plain and express proviso, that such aggregate reserve payments shall amount to at least 93 per centum of the aggregate gross annual payments required to be made by the holder to obtain the maturity of the certificate.

The Court: The gross annual payment is the total annual [fol. 2550] payments made at the end of the time. If it is $120.00 a year the gross annual payments in ten years would be $1200.00.

Mr. Farmer: And of that seven per cent would cover commissions to salesmen and all expenses in loading.

The Court: That is right, but it may be taken out 50 per cent the first year and only two per cent the last year.

Mr. Farmer: But they are still bound by that 93 per cent.

The Court: That is my understanding.

Mr. Farmer: The figure Mr. Palmer asked about is this, that 18.9 cents of every dollar paid in by the contract holder is paid to salesmen as commission. That didn't cover the general operating expense; that was just salesmen's commission.

The Court: But we don't know from that information whether this money was paid in on contracts in their first year or the second year or what year, and therefore that element must be brought in in order to make any comparison. That is all I am talking about.

Mr. Palmer: Your Honor, we think that this does do that, [fol. 2551] in that it takes in gross total payments over a ten year period of time.

The Court: Yes, but you have just brought out in evidence a number of times here that contracts are lapsed in large percentages, and that it is only the exception where a contract runs to maturity; only 10 per cent of them, I believe you said, run to maturity, and a very large proportion of them are lapsed in their very early stages.

Well, anyhow, it is five minutes after twelve. We will adjourn till 1:30.

(At 12:05 P. M. a recess was taken until 1:30 P. M.)

After Recess

1.30 P. M.

Mr. Palmer:

Q. Mr. Risley, under the Investment Companies Act of 1940, as very kindly explained by Mr. Reinhardt, it shows that on a contract paying in $10 month for ten years, a total of $1200, that the maximum loading for all purposes would be seven per cent of that, or $84. Now, with the normal expenses that the company would have, together with salesmen's commissions and together with selling expenses other than salesmen's commissions, was it deemed [fol. 2552] possible by the company to live within that loading of $84 on each total contract?

Mr. Ray: If it please your Honor, we object to that, because I think it is clear from the evidence that is in that the income from the loading will not be $84 on every contract sold. For every one that lapses that proportion will be larger and there will be more money than $84 per contract available for these expenses, and the question should be based on the total income available, not on the income which is available from a contract which is sold and which the purchaser completes the payments on.

The Court: The Court will ask the witness to take that element into consideration in answering this question.

Mr. Reinhardt: Your Honor, I would just like to say this. Mr. Ray said that on a particular contract which might have lapsed the amount of the loading might be more than $84. I think under the Act that is not true. While the percentage of the amount paid in might be more than 18 per cent or any given percentage up to 50 in the first year, that would be a [fol. 2553] percentage of $120 if it were a contract that called for $120 a year.

The Court: And it takes the whole thing to make the $84.

Mr. Reinhardt: That is right, so that in the first year there might be $60 of the $120 available, but over the entire life of the contract there would be $84 available.

Mr. Palmer: Am I correct in this, that $84 is the maximum amount of the load allowed on any contract, regardless of whether it went on two years or until completion?

Mr. Reinhardt: If the contract called for payments of $1200 over the life of the contract, but of the $84.00, $60.00 might become available in the first year. $60.00 would be 50 per cent of the first year's payments, although it would be a much smaller per cent of the aggregate payments. I thought I might have to object, and I may be able to save that objection by bringing this out. The 18.9 per cent is a percentage of all payments received by the company. That is, if in the payments received by the company, certain of them represented payments on the first year of the contract, [fol. 2554] the average of those would be 18 per cent of the amount paid in; it wouldn't necessarily be 18 per cent of the total payments made by any particular contract holder.

Mr. Palmer: But the 19 per cent approximately was the total percentage allocated to salesmen's commissions of every dollar paid in over a ten year period of a contract.

Mr. Reinhardt: That is my understanding.

The Court: But not over a ten year period of the same contract necessarily.

Mr. Palmer: Oh, no.

The Court: The contracts on which payments were made during that ten year period conceivably could all be first year contracts. Probably they were not, but if, as a matter of fact, only 10 per cent of the contracts are carried to completion, then there would be a much larger percentage of those contracts that are in their early stages than there would of contracts in their older stages.

Mr. Palmer: I think the Court is unquestionably right. My question to Mr. Risley is, if $84 is the total amount

[fol. 2555] allowed on any contract, regardless of whether it is carried to completion or not, whether the company could live, with all its expenses, not only salesmen's commissions of 19 per cent but all its other expenses, within that loading.

The Court: I have asked him to answer that question taking into account the experience of the company with reference to lapses.

A. Taking the experience of lapses into consideration, I believe the company could operate profitably at that, but if 100 per cent of the contracts sold and issued went all the way to maturity there is a question in my mind as to whether or not the $84 would cover all the expenses of selling and administration for a period of ten years.

Mr. Palmer:

Q. The evidence further shows, Mr. Risley, that 25 cents of each dollar paid in during that ten year period from 1927 to 1936 was spent by the company for total expenses, including salesmen's commissions. Would that be an abnormal period between 1927 and 1936?

Mr. Ray: It is not a question of whether it was an abnormal period. But it is a question of whether there [fol. 2556] were any expenditures which were larger than they should have been during that period.

The Court: I suppose this question is leading up to that.

Mr. Palmer:

Q. Would that be an average period of the company's existence?

A. I would say not.

Q. And is that based upon the fact that there was both a very high period of activity in the stock exchange and a very deep period of depression in the country?

A. That is quite true. During the boom days prior to 1929 we had a number of contract holders who would come in and discontinue their contracts because they could make more money in the stockmarket than they could on one of our contracts; and after the crash it was an emergency proposition then; they needed the money for several purposes to cover up on margin accounts or to live on, which caused our cash surrenders and discontinuances to be abnormally high.

Q. My question, which could have been stated better, was directed more at whether it was an average period in [fol. 2557] the company's existence in reference to expenses of the company.

A. And that period was from 1927 until when?

Q. 1936, inclusive.

A. I believe outside of some—you might say abnormal income tax and stamp tax cases, which involved considerable legal expense, that it was more or less a normal period.

Q. If it was necessary during that period to spend twenty-five cents of each premium dollar received by the company for total expenses, it would be obviously impossible for the company, or a new company reorganized, to live within a seven cent on each dollar total expense? Isn't that true?

Mr. Huwe: I object to that, your Honor. There are too many conjectural question involved about future management and future rates of interest and a lot of other factors.

The Court: I would permit that question to be asked and answered except for the fact that it still doesn't take into consideration the elements that we have been talking about, because it is conceivable that under the seven per cent [fol. 2558] limitation it is possible for twenty-five cents out of every dollar of the income of the company to be used and still keep within that limitation, depending altogether upon the age of the contracts that are being paid on.

Mr. Palmer: Your Honor, I can't quite follow the Court on that, as I could on the selling part, because this shows that of every dollar paid in over a ten year period, twenty-five cents went to necessary expenses of the company.

The Court: Let's suppose, Mr. Palmer, that all contracts being paid on in that ten year period were running their first year; that they always lapsed after the first year: then, even under the restrictions imposed now there might be 50 cents of each dollar used for that purpose and still not exceed the loading.

Mr. Palmer: Your Honor, the company, in that case, would, of course, not have expenses of setting up reserves, not have expenses of purchasing securities with those reserves, would not have expenses of collecting the many payments and so forth which would be deducted and taken off. In other words, if the policies only went one year, the [fol. 2559] expense of the company would be correspondingly less, so that the average of 25 cents over a ten-year

period would be a fair average of what the company needed during that period for expenses.

The Court: The setting up of reserves is not a part of expenses.

Mr. Palmer: Yes, it would be an expense to the company.

The Court: I don't so understand it.

Mr. Palmer: I understand all the fees paid to Mr. Young, all the managerial fees, are part of the expenses of the company.

The Court: Oh, yes, I thought you said setting up reserves was an expense.

Mr. Palmer: It is an expense to set them up on the books and make the required deposits in the various funds. All those require bookkeeping and a great many services in the offices. If you don't have to do that those expenses would be wiped out.

The Court: Let's let him answer the question. I think the witness is able to make those distinctions I have pointed out.

The Witness: Would you read that?

[fol. 2560] (The question was read.)

A. It would be impossible for the company to live on a total expense allowance of seven cents, but the experience with this type of business would indicate that the amount permitted for expense, even under the Investment Companies Act of 1940, would be greater than seven cents, and whether or not an old company or a newly organized company could exist would depend upon its management entirely.

Mr. Palmer: That is so far as loading goes?

A. Yes.

Q. I think you had started to tell us that one of the principal reasons the company couldn't exist under the Investment Companies Act of 1940 had to do with the amount the reserves had to be improved. Will you explain that?

A. The Investment Companies Act of 1940 required that the reserves behind or securing the contracts outstanding must be on a three per cent—or 3½ per cent basis—and if the company was in existence with a higher rate required on its reserve improvement, that a deficiency reserve had [fol. 2561] to be created that would equalize the two funds on a 3½ per cent basis.

Q. The Act also requires a net capital structure of $50,000, and the evidence here discloses that as of at least June 6th, 1941, the general fund of Fidelity showed a deficit of $2,600,000. Didn't that feature also play some part in the company being unable to comply with the Investment Companies Act of 1940?

Mr. Ray: May it please your Honor, we object to that because those are market values, and they are not the convention values which are used in valuing life insurance company holdings and annuity company holdings.

The Court: Overruled.

A. If that is the valuation as of June 6th, of course I was not with the company at that time.

Mr. Palmer: That is correct.

A. Not actively; and if that is the correct figures and showed a deficit of $2,000,000, why, of course, that was another reason that the company could not comply.

Mr. Huwe: Your Honor, I move that the question and answer be stricken on the ground that the question is directed at the feasibility of a reorganization, if not good faith, and on either basis the question of whether they can [fol. 2562] raise $50,000 for reorganization is not taken into consideration, the question of modifying any contract is not taken into consideration, nor is any other feature of the reorganization plan taken into consideration. Before a proper question can be raised as to the feasibility of a reorganization plan or the good faith with reference to a plan, those factors must be put to the witness, and then his answer must be made in the light of such factors. That question and that answer did not include those features.

The Court: As I understood, this question was simply whether or not lack of capital, in view of the deficit, was one of the elements that made it impossible for the company to comply with SEC requirements prior to any receivership or reorganization proceedings.

Mr. Palmer: That is correct, your Honor.

Mr. Huwe: But, after all, the questions relate to the two fundamental questions, and if that question as to whether or not they could comply with the SEC requirements does not bear on the two fundamental questions, it still is not relevant.

The Court: I am not sure that it does have a bearing, [fols. 2563-2568] but we have admitted quite a bit of evidence on that, so I will let it in over your objection.

Mr. Palmer:

Q. Mr. Risley, it is true, is it not, that before you left the company you knew and the company knew that the general fund, which was the capital structure fund of the company, was seriously impaired?

A. If valued on a market basis.

Q. Yes.

A. That is right.

* * * * * * *

[fol. 2569] Q. When did you first meet Mr. Messick?

A. I would say it was probably in March prior to the voting trust arrangement and the Rosset and Messick agreement.

Q. Who was it that made or arranged the contract between him and Fidelity? In other words, how did Mr. [fol. 2570] Messick come into the picture and offer the $500,000, and who was the person he contacted to talk about it and who formed the foundation upon which the written contract was later made?

A. Mr. Pulfer.

Q. Did he conduct all those negotiations or did later anyone else come into the picture?

A. He just conducted the preliminary negotiations, and then the matter was brought to the attention of the folks in Wheeling, and then we went to Chicago, is where I met him——

Q. Who is we? Was Mr. Marshall with you on that?

A. No. No, Mr. Koontz and Mr. Foulk. We made several trips to Chicago.

Q. And was there finally a contract arranged?

A. There was.

Q. Tell the Court how this voting trust agreement came into existence—the grounds behind it, not the actual existence of it. We know it; it is here.

A. Well, in order to give control to the—what we termed the incoming money, it was necessary to create a voting trust which would guarantee fulfillment of that contract.

[fol. 2571] Q. Without going into the exact details, was this the situation, that Mr. Messick wanted to deal with one

person who would be authorized to deal in behalf of the company? Did that play any part in it?

Mr. Ray: May it please your Honor, wouldn't the contract speak for that?

The Court: I don't know that the contract would have anything to say about that.

A. Well, considerable thought was given as to the best means of arranging that power, and it was deemed best to have it in one individual.

Q. And that one individual then having the majority control of the stock of Fidelity in his hands, if the agreement were carried through, would then be permitted to transfer that majority control to the new capital or Mr. Messick and his associates? Was that in substance and in layman's language the idea of it?

A. I think that is a correct statement.

Q. And was the voting trust entered into for any other purpose than to carry through this contract with Mr. Messick if that could be done?

A. I don't know.

[fol. 2572] Mr. Ray: Your Honor, I know that is objectionable. The voting trust certainly is the best evidence as to the purposes of it.

The Court: Overruled.

What did you say?

A. I believe not.

Mr. Palmer:

Q. Mr. Risley, when did Mr. Messick come in as chairman of the board?

A. I believe in the month of May.

Q. Of what year?

A. 1940.

Q. All right. Do you know how that happened to come about, that he became chairman of the board?

A. Mr. Pulfer reported to the directors that Mr. Messick had been offered other connections, and he felt that the company needed his services in completing this new capital procurement, and it was considered by the entire board of directors, who at that time believed that that was the proper thing to do, to retain Mr. Messick, and they elected him chairman of the board.

Q. Isn't it true that Mr. Messick, although he was one of the contracting parties to furnish this $500,000, was not [fol. 2573] going to furnish it himself, but that he was more or less a broker or go between between the company and the person or persons who would furnish that capital?

A. Well, that I don't know.

Q. When did Mr. Fleming first come into the picture, so far as you know?

A. The first that I heard of Mr. Fleming was some time during the month of June. I heard that he had attended the directors' meeting at Pittsburgh on June 3rd.

Q. That is the first time you ever saw him in the picture?

A. It is the first time I ever heard of the man.

Q. Did you know a Mr. Weaver?

A. The attorney from Chicago?

Q. Yes.

A. Yes.

Q. What part did he have in the transformation or trying to transform Fidelity from a face amount securities company into an insurance company?

A. He having had considerable experience in the life insurance field, he was engaged sometime during 1940, probably in the early summer, to assist in preparing the [fol. 2574] life insurance policies and the rate book and all the paraphernalia that goes with a life insurance company.

Q. Who was the person or persons who brought him into the Fidelity picture?

A. Mr. Messick introduced him to us.

Q. State whether or not Mr. Weaver, if you know, prepared a booklet or brief in which he proved, or attempted to prove, that Fidelity was already an insurance company prior to January 1, 1940?

A. I have heard him say that, but I have never seen any written evidence—anything that he has prepared in writing.

Q. For how long a period of time prior to the actual change of charter of Fidelity from its former name to its present name was the idea of Fidelity as an insurance company discussed or talked about by the officials of the company, including the board of directors?

The Court: You mean the iden of changing it from what it was to an insurance company?

Mr. Palmer: Yes, your Honor.
The Court: All right.

A. I would say about five or six months prior to the [fol. 2575] actual change.

Mr. Palmer:

Q. State whether or not that was discussed at the board of directors' meetings.

A. It was.

Q. Was it discussed with Mr. John Marshall, the general counsel?

A. Yes, sir.

Q. Am I correct in stating that Mr. Tom Foulk was your local attorney and that Mr. John Marshall was your general counsel?

A. That is right. Mr. Foulk's title was general attorney, and Mr. Marshall's general counsel.

Q. Was that idea discussed with both of them?

A. Yes.

Q. And was it also discussed with the firm of Koontz & Koontz?

A. It was.

Q. And I understand you to say Mr. Weaver, an attorney of Chicago?

A. Yes, he is at the present time.

Q. Was it the intention of the company to determine if something couldn't be done to save the company by virtue [fol. 2576] of turning it into an insurance company? Is that correct?

A. Well, the idea was that the insurance field offered broader opportunities for profit. At least, that was the way we felt about it.

Q. How long prior to January 1, 1941, was it that the officials of the company and the board of directors knew that something would have to be done in order to preserve the company as a going concern? How soon did they first start discussing that? Was that at the same time they started discussing an insurance company or before or later?

A. As I recall now, we first started, I would say, to try and conform with the Investment Companies Act of 1940 by preparing a new form of contract, and it was some time after that that the insurance idea took form.

Q. In other words, I gather from your statement that when the Investment Companies Act of 1940, either before or at the time of its passage, was brought to the attention of the officials, they knew that something would have to be done to change the then form of Fidelity? Is that correct?

[fol. 2577] A. That is right.

Q. And that the first thing that was thought of was to try to develop a new form of annuity contract?

A. That is right.

Q. And that idea was abandoned and the idea of an insurance company began to be talked about?

A. That is right.

Q. And the company went so far, did it not, as to change its charter to a life insurance company?

A. That is correct.

Q. And it changed its preferred stock to common stock, in order to comply with the insurance laws, which permit only one class of stock? Isn't that true?

A. That is right.

Q. And isn't it further true that the company took out an insurance license, although no business was ever done under it?

A. That is right.

(There was a discussion off the record.)

Mr. Palmer: I will make the following offer into the record. I offer to prove by this witness, if permitted, that in the early part of 1938 Mr. Jaegerman, Mr. Chapman, and [fol. 2578] other gentlemen from the Securities and Exchange Commission came to the home office of Fidelity Investment Association for the purpose of investigating the company and spent a number of months there; that Mr. Arthur Koontz, at the request of the board of directors, got in touch with Mr. Lane, general counsel of the Securities and Exchange Commission, and asked that if it be discovered that Fidelity was doing anything that, in the opinion of the Securities and Exchange Commission, was improper, that Fidelity be notified and a conference had to see if that matter could not be corrected; that in December of 1939, Mr. Koontz being in Washington, was notified by Mr. Lane, upon an inquiry, that there had been very serious matters discovered in the investigation, and thereupon called Mr. Risley and Mr. Tom Foulk to come to Washing-

ton; that upon arriving in Washington they called Mr. Lane, and he informed them that they could not have a conference with the Securities and Exchange Commission concerning the practices, because a suit would be filed that day; that they were not advised as to where it would be filed; that newspaper reporters informed them it was filed [fol. 2579] in Detroit, and that the Securities and Exchange Commission handed out news releases to the newspapers which were widely printed and which news releases had been prepared by the Securities and Exchange Commission or their employees, which news releases were extremely unfavorable to Fidelity and which seriously affected the sales of their securities after that time. That is the offer to prove.

Mr. Reinhardt: I feel called upon to say now, your Honor, that I don't know what the facts are as to this of my own knowledge, and as to most of it I do not even have any information, but I do not want it to be taken that I am admitting that this evidence would be uncontradicted or that it represents the facts.

Mr. Palmer: Well, Mr. Jaegerman is here present and can answer whether those facts are correctly stated.

Mr. Reinhardt: I have consulted Mr. Jaegerman about that. He says he has no personal knowledge of all of those facts.

Mr. Palmer:

Q. You say that you were in Washington when news of the SEC suit in Detroit reached you? Is that correct?
[fol. 2580] A. That is correct, yes, sir.

Q. I would like you to tell the Court how Mr. Koontz came to be then employed to take charge of the defense of that suit or the negotiations of the SEC about it, and whether it was a desire upon his part to be employed or the contrary.

A. Purely by coincidence the investment committee had scheduled a meeting in Washington that same morning, and the president of the company was there——

Q. Who was that at that time?

A. Colonel Thompson. Mr. Sutherland, Mr. Walter Grosscup, Mr. John Marshall, Jr. Mr. Koontz was a member of the committee at that time, and Mr. Foulk and myself of course were there for the purpose of the conference

with Mr. Lane, and the committee immediately went into session, and as they constitute a majority of the board of directors they took it upon themselves at that time to request Mr. Koontz to handle our case for us. He advised us that he had been offered another assignment which would take him to the Pacific coast.

Q. Did he say who that was?

Mr. Huwe: I object.

[fol. 2581] The Court: Overruled.

A. Mr. Giannini.

Mr. Palmer:

Q. Of what company?

A. Of the Bank of California or——

Q. Would it be Bancamerica?

A. Bancamerica, I guess—which would mean considerable money to him, but finally he agreed to represent us and did not accept the California assignment.

Mr. Huwe: Your Honor, I move that all of the last answer be stricken from the record on the ground that it in no way shows that Mr. Thomas was concerned with that particular procedure. The only reason we are bringing in the Koontz & Koontz work in this proceeding is where it has a tendency to show Mr. Thomas's ability as a state receiver. None of that question or answer shows in any way Mr. Thomas's specific connection with that proceeding.

The Court: Overruled.

Mr. Palmer:

Q. And state whether or not the board of directors and the committee then present had to use some persuasion to get Mr. Koontz to take the assignment of the defense of that case.

A. I would say that they did.

[fol. 2582] Q. Now, leaving that, I will ask you if you know Mr. John Marshall, Jr.?

A. I do.

Q. And I will ask you if you know that after graduating from Yale University he was employed for approximately a year by a prominent New York brokerage or banking house?

A. I understand that he was, yes, sir.

Q. And did you know that following that he then became general sales agent of Fidelity in the Baltimore district?

A. I think that you will find that he first became a salesman in the Washington office and then subsequently was given the Baltimore assignment.

Q. And how long was he connected with the sales end in the field for Fidelity before he came to the home office?

A. In my best judgment about two years.

Q. About what?

A. About two years.

Q. When he was brought to the home office what was the title given to him?

[fol. 2583] A. Vice president.

Q. State whether or not he was put upon the board of directors.

A. He was.

Mr. Ray: Your Honor, may we inquire what the pertinency of this is, or the relevancy of it?

Mr. Palmer: Yes, I will be glad to show you in just a few minutes with a question.

Q. What age was Mr. Marshall, Jr., at that time, approximately?

A. I would say around twenty-eight or thirty.

Q. State, if you know, whether he was brought to the home office and made a vice president and director at the request and through the influence of his father, John Marshall, Sr.

A. I have been so informed.

Q. State, if you know, if this, in all fairness to Mr. Marshall, Jr., was done without his, John Marshall, Jr.'s knowledge?

A. I believe that it was.

Mr. Palmer: Now, your Honor, the purpose, I believe, is obvious, in showing the activities of Mr. John Marshall, [fol. 2584] Senior in the company and his influence in the company. That is the purpose of it, and nothing else.

Mr. Ray: I move that it be stricken from the record, your Honor. It has no relevancy to any issue involved in this proceeding.

The Court: Well, I am going to leave it in. However, it seems to me there has been no denial anywhere of what you say you are trying to prove, namely, that Mr. Mar-

shall was influential in the company and a large stockholder and had a good deal to do with it.

Mr. Palmer: I understood from Mr. Marshall's own testimony that he had denied that, had denied taking an active part in the company.

(There was a discussion off the record.)

Mr. Palmer:

Q. Mr. Risley, Fidelity actually was changed—the charter was changed—to an insurance company in December, 1940. Is that correct?

A. December 31, I believe.

Q. State whether or not thereafter numerous conferences were had among the directors as to what to do in order to get the company operating as a going concern again.

[fol. 2585] A. There were many conferences.

Q. State whether or not you spent some time in Charleston at the office of Koontz & Koontz.

A. I did.

Q. About how long a time were you there, not continuously but from time to time.

A. I spent from one to four days continuously at different periods up until April.

Q. Did you also confer with Mr. Marshall and other members of the board of directors and Mr. Foulk, the general attorney?

A. Mr. Foulk daily and Mr. Marshall occasionally.

Q. And was everything attempted that could lawfully and reasonably be attempted to begin the company's operations as an insurance company?

A. I believe so.

Q. Were there a number of plans prepared by Mr. Latta, the actuary of your company?

A. There were no completed plans up until the time that I left.

Q. No, I meant tentative plans, hoping to arrive at something that could be definitely worked out.

[fol. 2586] A. Oh, yes. There were several ideas advanced by Mr. Latta.

Q. And those were put into—I will call it a rough-draft form—typewritten up and in shape so that you could work on them and see what could be done with them?

A. Not while I was there.

Q. State whether or not you had conferences with Mr. Sims, the State Auditor, during this period.

A. I did.

Q. Did you have conferences with Mr. Messick during this period?

A. Yes.

Q. Now I wish you would advise the Court what, if any, efforts were made over the last two or three years since the SEC suit of 1938 by yourself, by Mr. Koontz or others, to attempt to attract new capital into the company, other than the Mr. Messick deal, of which we know.

A. That was almost a continuing operation from one group to another, from as far as Cleveland and New York and Philadelphia.

Q. Did Mr. Koontz have a discussion and prepare figures [fol. 2587] and present to Pell, Ltd., of New York, if you know?

A. I believe that Mr. Young presented figures to them upon the request of Mr. Koontz.

Q. State whether or not Mr. Grosscup had some people in Philadelphia that he tried to interest?

A. He did.

Q. Who were the people in Cleveland, if you know, that were attempted to be interested?

A. I believe it was Otis and Company.

Q. Can you tell us whether Mr. Messick attempted to get people in Chicago and that vicinity interested?

A. He has said that he did.

Q. So that there was a continual effort to attempt to refinance Fidelity?

A. Yes.

Q. And did that refinancing include the idea that it would be reorganized as part of the development or putting new capital into it?

A. Some of the plans contemplated that; others just contemplated the issuance of additional capital.

The Court: Let me ask you this, Mr. Risley. In these [fol. 2588] efforts of Mr. Koontz to procure new capital, what representations did Mr. Koontz make as to whether or not the company was in a sound condition and whether or not there was a reasonable prospect for it to continue in business if new capital were put in, and other representations of a like kind, if you know?

A. To my own knowledge, I know that the audit reports made by the Certified Public Accountants were furnished to these people for study, which included Mr. Morris of the Morris Plan Bank, Mr. Floyd Odlum, and Otis and Company—I think their office is in Cleveland— and Mr. Young supplemented that with an analysis of the securities portfolio.

Q. But that is not my question. I want to know what representations Mr. Koontz made along that line.

A. Well, I couldn't tell you that.

Q. Well, I thought you said that you knew he was trying to get new capital.

A. He was, but as to what statements he made to these people, I don't know, because I was not present.

The Court: All right.

Mr. Palmer:

Q. You do know that at his request the certified accounts [fol. 2589] of the company were sent to these people for their investigation and study?

A. Yes, sir.

Q. And you do know that Mr. Koontz happened to be acquainted with or to become acquainted with a number of highly reputable financial people whom he hoped or the company hoped might invest in the company?

A. That is correct.

Q. That covered a period of time from when to when?

A. Immediately following the conclusion of the bankruptcy case in Wheeling right on down to the adoption of the insurance plan.

Q. One other thing, Mr. Risley. You naturally have had access to all the books of the company, have you not?

A. Yes, sir.

Q. And as a director you have access to the minutes of the board of directors, I believe? Is that correct?

A. That is correct.

Q. And isn't it true that you know generally, without specifically mentioning any one amount, the fees generally that have been paid to Mr. Arthur Koontz or to his firm? [fol. 2590] A. In a general way, yes, sir.

Q. Will you tell us how those fees were investigated, if they were, by the company, to what committee or commit-

tees or attorneys they were referred, before action was taken on paying them?

A. Well, since about 1926 or 1927 the attorney bills—the bills for attorneys' fees were submitted to the general counsel.

Q. That is Mr. John Marshall?

A. (continuing) For his recommendation, and in case of extraordinary fees sometimes a committee was appointed from the board of directors to give it study.

Q. And do you know if that was done in the case of all the fees submitted by Mr. Arthur Koontz or his firm?

A. All the fees paid to Mr. Koontz were approved by the general counsel, and in some instances a committee passed on them.

Q. That was the fees in the larger amounts?

A. Yes, sir.

Q. Do you know whether or not, without asking your knowledge of law or legal fees, work was performed for [fol. 2591] every fee that was paid to Mr. Arthur Koontz or his firm?

A. Work was performed by every attorney that ever received a fee from the association while I was connected with it.

Q. And in all of the cases and fees paid to any attorney, in your opinion, were the services performed such as to warrant the amount paid them as fees?

A. In some cases I felt that probably the fees were high.

Q. And in those cases did you object to the payment?

A. We did. And in some cases we got reductions.

Q. Did that ever apply to any of Mr. Arthur Koontz's fees?

A. Not that I know of.

Q. There was never any objection raised by anyone as to their amount, to your knowledge?

A. Not to my knowledge, no.

Q. From the first of January of this year on until——

The Court: Just a minute before you start that, Mr. Palmer.

Q. Did you have any knowledge of Auditor Sims' objec- [fol. 2592] tion to the fees paid Koontz & Koontz?

A. No, I did not.

The Court: All right. Go ahead.

Mr. Palmer:

Q. Mr. Risley, from the first of January, 1941, until the state receivership proceedings were instituted, were you, together with others of the company, doing everything possible to get operating again and selling?

A. We were.

Q. And there was a letter introduced here in evidence, or a copy of a letter, addressed to Mr. Koontz by Mr. Sims, which stated in substance—dated March 25, 1941—which stated in substance—perhaps I had better get the exact letter. I will hand you Exhibit No. 94 and ask you to read it.

(Witness examines paper.)

A. Yes, sir.

Q. Did you see the original letter sent by Mr. Sims, or were you informed of the contents of it?

A. I believe I have seen that letter before.

Q. That letter states that Mr. Sims was intending to bring a state court proceeding, but also suggests that the [fol. 2593] company investigate the possibility of a federal proceeding for reorganization, Mr. Sims calls it under 77B. State whether or not, regardless of whether you saw that letter or anyone else did, there was a discussion among the officials of the company as to whether state or federal proceedings would be for the best interests of the company, that is, proceedings for reorganization.

A. There was.

Q. Did Mr. John Marshall and others partake in that discussion of the full board of directors or the board of directors that was in there?

A. They did.

Q. Do you recall whether or not Mr. Koontz brought this letter, or the substance of it, to their attention?

A. He did.

Q. Was there a conference had with the Securities and Exchange Commission as to whether state proceedings or federal proceedings would be for the best interest of the company, or at which that was discussed?

A. There was a conference relative to a plan that we had for revaluing—a plan that we had for revaluing the present outstanding contracts, and that was held in Wash- [fol. 2594] ington on April 1st.

Q. Of what year?

A. 1941.

Q. Who was present at that conference?

A. It was a very large conference. It was Auditor Sims, Mr. Justice, Mr. Koontz, Mr. Jaegerman, Mr. Jackson, Mr. Smith, their accountant, Mr. Lane, Mr. Klein, Mr. Schencker, Mr. Pulfer.

Q. Was Mr. John Marshall present?

A. No, sir.

Q. Was Mr. Messick present?

A. I think not.

Q. Was Mr. Tom Foulk present?

A. I don't recall him being there.

Q. State whether or not at that conference the matter of whether a proceedings in state court or federal court would be to the best advantage of Fidelity was discussed.

A. I doubt that it was discussed in the open session when all those people were there. I think it was discussed later on in the afternoon.

Q. With whom?

[fol. 2595] A. I think principally with Mr. Klein and Mr. Lane. That is a little bit hazy in my mind.

Q. State whether or not it is not a fact that the Securities and Exchange Commission said that they would not advise the company as to whether state court proceedings or federal court proceedings would be for its best interest.

A. They wouldn't make any recommendation which way to go.

Q. After that state whether or not the results of that meeting were reported to the board of directors and fully discussed by the board of directors of Fidelity as to whether state court proceedings or Federal court proceedings would be for the best interests of Fidelity.

A. Yes, sir, that was presented to the board of directors within a very few days after our meeting in Washington.

Q. Was Mr. John Marshall present at that meeting?

A. He was.

Q. And was Mr. Messick present at that meeting?

A. I am quite sure that he was.

Mr. Warner: If your Honor please, we object to this [fol. 2596] line of questioning on the ground that whatever was said there is not binding on creditors of the company.

The Court: Overruled.

Mr. Palmer:

Q. And isn't it a fact that at that meeting of the board of directors a thorough discussion was had by the directors of the company concerning the situation of Fidelity, that they had knowledge of the fact that proceedings of some sort were necessary to protect the assets until some plan or some reorganizatoin could take effect, and that after fully exploring the possibilities of state and federal court it was determined that they favored a proceeding in state court?

A. That is correct.

Q. And wasn't that a unanimous decision at the end of that conference?

A. Yes, sir.

Q. And isn't it further a fact that at that—I call it conference—a board of directors' meeting— there was then passed a resolution of the board of directors employing Koontz & Koontz and Mr. Tom Foulk to represent the debtor's interest in filing an answer to a proceedings to be brought?

[fol. 2597] A. That is correct.

Q. Isn't it further a fact that Mr. John Marshall employed Mr. Robert Riley, of the City of Wheeling, to help him and Mr. Messick and others in connection with this matter?

A. I believe that he did.

Q. When was this directors' meeting, as you recall it.

A. Around the 6th, 7th or 8th of April—sometime right along in there.

Mr. Huwe: What month?

A. April.

Mr. Palmer:

Q. After the state court proceedings were brought, Mr. Risley, when was the first time anyone ever informed you that there was to be a proceeding brought in federal court?

A. The first I heard of it was when I had a report of what occurred at the meeting in Pittsburgh on June 3rd.

Q. Were you notified of that meeting in advance?

A. I was.

Q. Who notified you?

A. I don't recall who signed the notice to that meeting.

[fol. 2598] I believe it was Mr. McNulty, the secretary.

Q. I may be mistaken—if I am, I trust that some of counsel will correct me—that Mr. Marshall testified that he personally notified you of the meeting and asked you to be present. If I am mistaken, I wish some of counsel or the Court would correct me. That is only my recollection.

Mr. Ray: That doesn't exclude the fact that he was given the proper written notice of the meeting.

Mr. Palmer: I agree with that, Mr. Ray.

The Witness: But I do not recall who signed it.

Mr. Palmer:

Q. Let me ask you, did Mr. John Marshall, Sr. contact you before that meeting by telephone or personally or otherwise before it took place?

A. No, the only notice that I had was this letter. If he signed it, then he did have contact with me, but otherwise not.

Q. Did anyone tell you, Mr. John Marshall, Mr. Fleming or Mr. Messick or anyone else, that at that meeting there would be taken up a resolution or a discussion even that this proceeding should be brought in federal court instead [fol. 2599] of letting the proceedings go along in state court?

A. No.

Q. You had no notice of that before that meeting at any time? Is that correct?

A. That is right.

The Court: Mr. Palmer, do the by-laws require that notices of directors' meetings state the purpose of the meeting?

Mr. Ray: I think it does at a special one. I think this particular notice does. That is what I was looking for, if you will give me a moment.

Mr. Palmer: I can't give the answer.

The Court: Then go ahead.

Mr. Palmer: If your Honor please, I believe that Mr. Pulfer promised us that he would send here the notice that he had received of that special meeting of June 3rd. It is not incorporated in the board of directors' minutes, and if I am not mistaken there has not been any copy produced by anyone of the written notice of that meeting. Mr. Pulfer promised that he would mail it immediately

upon his return and we have not heard from it yet. I [fol. 2600] wonder if someone can give us information about it. Mr. Ray, he was produced as a witness for the debtor. Can you give us any information concerning it?

The Court: I understand Mr. Ray is looking to see if he can find the notice now.

Mr. Palmer: Oh! good!

Mr. Ray: I have seen a copy of it, your Honor; I am just trying to find it.

Mr. Palmer: Well, take your time. I will go on with my other subject.

Q. After the state court proceeding was brought, Mr. Risley, were you kept on as an employee of the state court receivers?

A. For about eighteen days.

Q. How long, if you know, was Mr. John Marshall, Sr. and how long was Mr. John Marshall, Jr. kept on as employees?

A. That I don't know.

Q. Beg pardon?

A. That I do not know.

Q. Now, Mr. Risley, with reference to this particular company, isn't it true that you testified in Washington, [fol. 2601] D. C., before the Securities and Exchange Commission on January 28, 1938?

A. Yes, sir.

Q. At that time is it not true that the Securities and Exchange Commission had a large amount of data concerning Fidelity and had many charts and tables prepared by their experts for use in that hearing?

A. They had detailed information of eleven years of the company's operation.

Q. And did they have that presented and prepared in the way of charts so it could be easily studied and examined?

A. I don't believe they had any charts. I never saw any.

Q. Isn't it a fact that at that hearing you were asked if approximately 5.29 per cent of all contracts went to maturity, and that you stated you thought that figure was too low? Do you recall that?

A. I can't say that I do. I know that questions were asked concerning the maturity experience. If that is a copy of my testimony why that is——

Q. Well, isn't it true that at that time and since you [fol. 2602] felt that probably 10 per cent of those who invested carried their contracts through to maturity?

A. I would say at least 10 per cent would.

Mr. Ray: Your Honor, what I have is one of these copies of a copy. It is a copy made from the notice which Mr. Reed had. It is Mr. Reed's copy, and this was prepared and put in the minute book, and then, because it was addressed to Mr. Reed, it was not inserted in the minute book. If Mr. Palmer wants to ask the witness if he got a notice similar to that, I think it might be made admissible. It certainly is not now.

Mr. Palmer:

Q. I will ask you to read that and state if it is similar to a copy of the notice that you received of the board of directors' meeting?

A. I believe that mine was similar to that one.

Mr. Palmer: We have no objection to it being a copy of a copy, your Honor.

The Court: Let me take a look at it.

Mr. Palmer: Surely. (Handing paper to court.)

Mr. Ray: Your Honor, I think it should be put in the minute books or attached to the certificate of the man who mailed the notices, where it was originally intended [fol. 2603] to be put. I didn't think it was quite proper, and I didn't put it in.

Mr. Palmer: May I suggest it might be a good idea at your board of directors' meeting tomorrow to take that up and by some official action have it put in the book, rather than for us to put it in in a court proceeding.

Mr. Ray: May we mark it for identification?

Mr. Palmer: All right. Mark it as an exhibit rather than for identification.

Exhibit 96.

The paper referred to was admitted in evidence, marked as above indicated, and the same is attached hereto as a part hereof.

Mr. Palmer:

Q. There has been a number of plans of reorganization thought of and proposed and attempted long prior to this meeting, isn't that correct?

A. Several plans, yes.

The Court: Prior to what meeting?

Mr. Palmer: Of June 3rd.

The Court:

Q. You mean there were different plans discussed between the meeting of April 7th and the meeting of June 3rd?

[fol. 2604] A. I couldn't say to that, because I was not there.

Q. Well, the plans you have reference to that were discussed were discussed before the meeting at which the decision was made to have the Auditor bring a suit in the Circuit Court of Kanawha County?

A. And then they were discussed after the suit was filed in Kanawha County, and I participated in those discussions up until the 28th of April.

Q. Do you mean that there were discussions among the board of directors as to plans that the company would undertake for reorganization, or were those plans of the receivers?

A. They were just general plans of what would be fair and feasible to the contract holders in making any adjustment, which was the main topic of discussion at the conference with the SEC on April 1st and 2nd.

Q. What the Court is trying to get at is this. Was there any discussion that would look towards action of the company through its board of directors on some different plan of reorganization than the one started in the state court?

[fol. 2605] A. No, not after the case was filed in Kanawha County.

Mr. Palmer: I don't want to correct the Court, but the Court used language to the effect that it was decided to have Mr. Sims bring a suit in Kanawha County. I believe in the letter of Mr. Sims he said he was going to do it.

The Court: All right, submit to it, then, instead of having him do it.

Mr. Palmer: Isn't this true, Mr. Risley, that the company recognized that something must be done, and that they were not objecting to some sort of proceedings brought in order that the assets might be held in statu quo while the company could arrive at some reorganization plan?

A. That was the sole purpose.

Q. And that that is why there was no objection on the company's part to Mr. Sims suit? Isn't that correct?

A. That is correct, yes, sir.

Q. The company knew that there had to be something done, otherwise there might be a run on the company by cash surrenders which would give those who got there first their money and those who came last would not get [fol. 2606] any?

A. That is correct.

Q. So that the company had, through its officials, after this letter of Mr. Sims as well as before, discussed with Mr. Sims the possibility or need of such a suit, and also had discussed the possibility or need of a federal court suit? Isn't that right?

A. That is right.

Q. And it was only after a thorough discussion and weighing of all matters that the company decided that it preferred, if it had a choice, the state court proceeding?

A. After weighing the matter it was the unanimous opinion of the board of directors that the state court method would be the best.

Q. And isn't it further true that not only the sentiment, or the expressed sentiment, of the board of directors was that that state court proceeding would lead to a reorganization of the company rather than a liquidation of it?

A. Reorganization was the only thing that we were considering.

[fol. 2607] Q. There was no thought of any kind, either by Mr. Sims, by the SEC or by the company, of a liquidation, but only a thought of some sort of reorganization? Isn't that true?

A. Reorganization is the only word that I heard mentioned in any of those conferences.

The Court:

Q. Mr. Risley, how many of the men that you say were unanimously in favor of a state court proceeding were the same men who later held the meeting of June 3rd?

A. Well, if I have been correctly informed, it would be six.

Mr. Palmer: If your Honor please, might the board of directors' meeting of April 7, 1941, be read to show who

was there, so that Mr. Risley might anwser your question in the light of that?

The Court: Yes, go ahead.

Mr. Palmer: Reading from the minutes of the board of directors, "Quorum present, Chairman Messick presiding. Present: Messrs. F. S. Risley, F. H. Pulfer, John Marshall, Sr., John Marshall, Jr., H. E. Reed, D. A. Burt, A. L. King [fol. 2608] and Tom B. Foulk; Mr. R. A. Latta, actuary, present by invitation."

The Court: What I want to know is how many of these men changed their minds between that meeting and the meeting of June 3rd.

A. Well, as I said before, there would be six, if my information is correct, was the the number of directors that attended the meeting in Pittsburgh on June 3rd. I understand that Mr. Burt was not present, and I was not present.

Q. Mr. Burt has testified here that he changed his mind.

A. I see. I didn't know.

Q. And Mr. King has testified that if he had known of certain facts that he would probably have changed his mind also. Now, that leaves only you, then, that did not change your mind.

A. I didn't know anything about it.

Q. How about Mr. Foulk? Was he present at the June 3rd meeting?

A. No, I think he had resigned prior to that meeting.

Q. You don't know what his attitude was on June 3rd?

A. No.

[fol. 2609] Mr. Palmer: I am sorry, your Honor; I was reading these minutes. What was it the Court said with reference to Mr. A. L. King changing his mind?

The Court: I said he testified that had he been acquainted with certain facts he probably would have changed his mind as to the desirability of federal rather than state reorganization. I believe I am correct in that.

Mr. Huwe: That is right, your Honor. I asked him that question.

Mr. Palmer: I will ask to introduce in evidence the board of director's meeting of April 7th, 1941, as shown on page 173 of the minute book.

(The minutes referred to were read by Mr. Palmer.)

The Court: I understood this witness to say and to testify from the proceedings of the company that there was a unanimous decision at that meeting of April 7th that the directors preferred reorganization in the state court rather than reorganization under Chapter 10 in the federal court. On reading these minutes I see no mention of that. What is the explanation?

Mr. Palmer: I don't know, your Honor. Are you pre-[fol. 2610] senting the question to me or to Mr. Risley?

The Court: To you.

Mr. Palmer: I don't have any idea. And I know nothing about that. Perhaps Mr. Risley can tell us whether it was discussed and the minutes not taken down, or what the situation was.

The Court:

Q. Did you mean, Mr. Risley, simply that there was a unanimous vote on the resolutions that are in the book?

A. That is correct, and likewise it was the unanimous opinion of all the directors present that the proceedings about to be instituted by Mr. Sims was the best plan.

Q. I asked you something a while ago that may have included an assumption. I asked you if you were the only person, with the possible exception of Mr. Foulk who didn't change his mind about that between the 7th of April and the 3rd of June. I don't know whether you changed your mind or not, did you?

A. I had not been given any information relative to this proposed change and knew nothing about what caused it or why until I arrived here in Charleston last night. I have [fol. 2611] not been kept informed of the affairs of the association since I left.

Q. Can you say now whether, had you been present at the meeting of June 3rd, 1941, you would have voted for the filing of the petition under Chapter 10, or would you have voted against it? Could you say that now?

A. I don't believe, your Honor, that I have had sufficient information yet to make up my mind which way I would vote.

. . . . . .

[fol. 2612] J. H. SCHELLHASE recalled, testified as follows:

[fol. 2613] Cross-examination.

By Mr. Farmer:

Q. Mr. Schellhase, since you testified here last have you done some more figuring on this estimate of the income of the company and expenses?

A. Yes, I have.

Q. Will you just tell us what you have figured on it and how you figured it out?

A. I have made a more up-to-date schedule on that. Those figures were taken as of October 31, 1940. I have prepared or taken from the records the income and expense for the first five months and six days of 1941, or up until the time the trustee was appointed. Then I have estimated the income and expense for the next seven months, so that in my figures there is actual figures for the first five months and six days and an estimation for seven months. The six days in between there didn't amount to much, because all of the income comes in or is credited around the end of the month, so the first six days there is not much difference in there. So that for the year 1941, if improvements were allowed to go on or to be put on the reserve funds for the [fol. 2614] entire year,—of course they were for the first five months, or up until April 10th, rather—but if they were to go on for a whole year the loss would be $453,847.92; but in that figure there are security losses of $275,000 approximately, which are chargeable against principal and not against income, since the value of the securities were set at April 10th, the market values of them, any security losses would be charged against the principal instead of against the income of those securities.

The Court: Losses on account of decrease in market value?

A. Yes, sir, any sales that were made, your Honor, in between that time.

Mr. Ray: State what the loss was in this case.

A. It was losses on stocks held as collateral on a bank loan over in the Continental Illinois Bank in Chicago—had to be sold to pay off the loan.

Mr. Farmer:

Q. Were they sold?

A. They were sold.

Q. That was after April 10th?

A. Yes.

Q. Was that loss the difference between the amount [fol. 2615] realized and the book value?

A. That is right.

Q. The book value and not the market value?

A. That is right. They secured so much for them, and the book value was so much, which resulted in a loss of approximately $300,000.

Q. You said $250,000.

A. I said $275,000, but I have taken off of that figure a little gains that were made on sales, so the approximately loss was $275,000, which was eliminated from your $293,000 loss and would give you a loss of $878,823.24, which I have figured ,and have estimated the expenses for the last seven months to be $90,000 and the expenses for the first five months were $164,000, $254,200.29 of expense, which, if eliminated from your loss of $178,000, would leave you a balance for the year 1941 of $75,977.05.

The Court: For the whole year, or for the seven months?

A. It would leave that for the whole year, your Honor. That is taking the actual five that has already gone and estimating seven months. Now, if no improvement was [fol. 2616] made to the reserves after April 10th, and we used the actual figures for the first five months and the estimation for the seven months, leaving out the improvement that was estimated for the seven months that has not been put on the reserves, we would have a profit of $249,524.06, of which security losses of $275,000 is included in there, would boost your profit up to $524,548.74, and taking also my estimated expense into consideration of $254,800.29, would give you a profit of $779,349.03, or an income of $779,349.03, which would be—could be used for expenses.

Mr. Farmer: You said that was without any improvement on reserves?

A. That is with improvement up to April 10th on the reserves, the actual improvement.

Q. Up to April 10th?

A. Yes.

Q. And the total amount of the improvement for the whole year 1941 on the contract basis is $1,050,000?

A. I estimated it around $1,050,000, that is, using the different rates of improvement. Of course, you can't tell the exact figure on that, but that is including an estimation [fol. 2617] and the actual figure. Also for the year 1942, if no improvement was made to the reserves and the securities were practically the same as they are now, if there were no—not a lot of sales or somebody didn't go out and sell a lot of them and we were allowed to reinvest the income and also any called bonds that we would have to turn over, we were allowed to invest that income, I estimate the income from this to be $952,831.97, with expenses of $153,699.23, total amount of net income $799,132.74. Of course, this estimation of expenses does not include any extraordinary expenses of the trustee or trustee's fee, because I don't know what they are going to be.

Q. In other words, then, for 1942 on that basis you would not realize enough income to cover the required improvement of the reserves on the contract?

A. Well, it depends on a lot of—there is a lot of factors that enter into that. My estimation is made on the assumption that the reserves would not be improved. If they were improved——

Q. I am asking you——

A. Wait——

[fol. 2618] Q. Answer, if you don't mind.

A. I would like to elaborate on it first.

Q. First, this amount of the gross income is not as much as the required amount to be allocated for the improvement on the reserves would be.

A. It depends on what you call the gross income.

Q. Your figure there of $707,000 would be gross.

A. That is net income.

Q. All right, what is gross?

A. Gross income is $952,000.

Q. Well, gross in less than the amount required for the improvement on the reserve.

A. No, I wouldn't say that, for the reason that when you consider improving the reserves you also have to consider interest on contract loans that I did not consider in this income for 1942. If we stop the improvement to the reserves we also have to stop the interest on our contract loans that the contract holders pay us, so that we—I can-

not say—you cannot say that the income that I have estimated here could be applied against the amount of improvement that we had to put on the reserves, because you will [fol. 2619] have to take into consideration the interest on contract loans.

Q. What was the interest on contract loans?

A. $82,000.

Q. All right, assume that you had the whole amount, $82,000, and added that to your gross income, it would still be less than the improvement on the reserves required for the year 1941, wouldn't it?

A. It would be about the same.

Q. Well, it would be less.

A. Well, $20,000.

Q. Less. And if you took the net income instead of the gross, the net income is how much less than the gross?

A. The net income is $799,000.

Q. How much do you figure for expenses there?

A. $150,000.

Q. So that you would be $170,000 in the red, that is, if you figured improvements on the reserves for 1942?

A. Sure, but I don't see how you could figure the improvement on the reserves for 1942.

Q. Well, that is for the Court. Of course, you would [fol. 2620] not——

A. Because you have to take into consideration your contract loan interest.

Q. And you said that was $80,000.

A. Approximately $82,000.

Q. That is before your estimate of expenses? You didn't include anything for administrative expenses, court costs, trustee's fees and attorneys' fees, did you?

A. No, there isn't anything in here for that. I didn't know what to do on that.

* * * * * * * * *

[fols. 2621-2623] Fred Risley recalled, testified as follows:

Examination By Mr. Palmer:

[fol. 2624] Cross-examination.

By Mr. Lauritzen:

Q. Mr. Risley, I believe you testified a moment ago that after you changed the charter on December 31, 1940 to

that of a life insurance company and filed policies with the state and got a license and had Mr. Weaver work out rate books and so on, that you were doing everything you could to begin the life insurance company operation?

A. That is correct.

Q. Can you tell us, Mr. Risley, whether that included the contact with any of the various state insurance commissions to ascertain what their attitude was with respect to your company conducting a life insurance company in those states?

A. We did not reach the point of contacting any foreign [fol. 2625] states or insurance commisioners.

Q. Only West Virginia?

A. That is all.

Q. Do you know whether there were any conferences, informal or otherwise, along that line with anyone from the Illinois Insurance Commission involved?

A. Not of my own knowledge I do not know of any. Mr. Weaver or Mr. Messick may have contacted them. I couldn't say that they did.

Q. You do not know one way or the other?

A. No.

Q. Now, Mr. Risley, after the SEC injunction in 1938, it became apparent to the company that one of the things you would have to do from that point on would be to see that contract holders to whom you were selling contracts got proper information as to the nature of the company and the facts and figures behind it. Am I correct in that?

A. Yes, sir.

Q. The SEC's big criticism of Fidelity was that they did not disclose certain things to purchasers and prospective purchasers. Is that correct?

[fol. 2626] A. That is correct.

Q. Now, I would like to show you these booklets, Mr. Risley, that have been introduced here as Exhibits 83 to 87, inclusive, and ask you whether those booklets were worked up by Fidelity or anyone connected with it after the SEC investigation and injunction?

A. Yes, they were.

Q. Now, looking at Exhibits 83 and 84 and then looking at Exhibits 85 to 87, can you tell us which of them contains more detailed information or what the difference in them is?

A. Briefly and quickly, I would say that the later series of booklets contained greater information.

Q. Calling your attention to Exhibits 85, 86 and 87, containing the financial statement of securities deposited with each of the various states having depository laws and containing above that schedule what is known as a foreword. That foreword was not inserted in these earlier booklets. Am I right in that?

Mr. Reinhardt: If this witness is testifying on his present examination of these books, I submit that the Court can do that as well as the witness.

[fol. 2627] Mr. Lauritzen: I think he has testified he was familiar with them, Mr. Reinhardt. He was president of the company.

The Court: You are asking him, Mr. Lauritzen, what is in these booklets. They have already been introduced in evidence. Any question as to what is in them would be improper, because the Court already knows what is in them.

Mr. Lauritzen: All right; I think that is correct.

Q. Mr. Risley, after the SEC injunction did the SEC continue to keep a staff of people in Fidelity's office at Wheeling?

A. No.

Q. Not at all after the injunction?

A. No.

Q. Were conferences had between the representatives of Fidelity and the Securities and Exchange Commission as to what Fidelity should do so that it would not violate the injunction?

A. Frequently.

Q. Who had those conferences and with whom?

A. Mr. Koontz contacted them most frequently, and [fol. 2628] he reported his having them, I think principally with Mr. Klein.

Q. Mr. Robert Klein, Jr.?

A. Mr. Lane's assistant.

Q. Assistant to the general counsel?

A. Yes.

Q. And to your knowledge did the SEC know that these booklets which I have shown here, particularly 85, 86 and 87, were the booklets that were in use by Fidelity and were being distributed to contract holders and prospective contract holders?

A. I was informed that they had been submitted to them.

Mr. Reinhardt: Well now, I will have to ask to have that question and answer stricken, unless it is merely to prove that somebody told this witness that these had been submitted, because he testified that he does not know the fact.

The Court: Well, let's see if he does know. Do you know?

A. Only that the—Mr. Koontz was requested to submit the material to the Commission, and he reported back that [fol. 2629] he had and that they had no objection to the form in which he returned it. That is all I know about it.

The Court: All right. The Court can see the extent to which that is admissible. I overrule your objection.

Mr. Lauritzen:

Q. Mr. Risley, did the Securities and Exchange Commission at any time commence proceedings against Fidelity for contempt of the injunction decree entered at Detroit?

A. I believe they did.

Q. A contempt citation was issued?

A. No, I—I believe Mr. Lane went to Detroit, appeared before the council—or the court—but not—there was no citation issued to my knowledge.

Q. Well, do you know what action of Fidelity's he was criticizing at that time?

A. Let's see. I believe it was a statement—or a booklet prepared by President Thompson which was the chief objection.

The Court: Prepared by what?

A. Prepared by—for President Thompson, which was [fol. 2630] sent to the contract holders, explaining what had happened.

Q. Prepared by President Thompson? Is that what you said?

A. Prepared for him. It went out over his signature.

Q. Well, who prepared it?

A. I believe a man by the name of O'Brien that is in charge of the sales promotion department.

The Court: All right.

Mr. Lauritzen:

Q. Mr. Risley, as far as you know, the SEC, either by formal or informal action, never criticized your use of these booklets Exhibits 85, 86 and 87? Am I correct in that?

A. Yes, sir.

Q. And those were the booklets that you placed in use after the injunction and constantly used and delivered to all of your new prospects and purchasers? Am I correct in that?

A. You are right, sir.

Mr. Lauritzen: That is all.

Cross-examination.

By Mr. Reinhardt:

Q. Mr. Risley, so far as you know, clearance was never [fol. 2631] obtained from the Securities and Exchange Commission on any of these booklets?

A. By clearance you mean formal approval?

Q. That is right.

A. No, sir.

Q. Was informal approval ever obtained, so far as you know?

A. My understanding is that as far as the Commission went was to say that they had no objection to its use.

The Court:

Q. Who said it? This is the informal discussion that you are talking about.

A. Well, that, as I say, I understood that most of the conferences were held with Mr. Klein.

Q. By whom?

A. Mr. Koontz.

Q. So that any information you have about this is derived from Mr. Koontz?

A. Correct.

Mr. Reinhardt: Well now, your Honor, I understand Mr. Koontz is to come here and testify, and since he is the one who had these conferences, either this testimony is worthless or it should be stricken so it can be supplied by [fol. 2632] Mr. Koontz.

Mr. Palmer: If your Honor please, may I suggest, the question is what information the company had, and the information the company had would be the information given to the president.

Mr. Reinhardt: That is satisfactory.

The Court: If that is the purpose. I understood from Mr. Lauritzen the purpose would be to show, if he could, that certain statements in these booklets which were presented to contract purchasers in Wisconsin bore the approval of the SEC. Was that the purpose?

Mr. Lauritzen: Mr. Reinhardt, I think we can clear this up if you will just tell us, it is a fact, isn't it that the Securities and Exchange Commission under no circumstances ever issued an approval of any advertising document or prospectus issued by any issuer of securities?

Mr. Reinhardt: Absolutely.

Mr. Lauritzen: Now, let me ask this. If these booklets were in violation of the decree entered in Detroit at the suit of the Securities and Exchange Commission, I think that the SEC would have taken some action to stop them. Am I correct in that?

[fol. 2633] Mr. Ray: Your Honor, what has that to do with this proceeding—what the SEC might have done?

Mr. Reinhardt: Let me say this. In the first place, that comes under the jurisdiction of the enforcement division, not the reorganization division, and I feel a little out of my field in speaking about what the enforcement division would do. However, I understand that it might well be that the Securities and Exchange Commission would not take action even though it felt that these booklets violated the injunction, or it might further be that the enforcement division had not yet recommended that action be taken and that they contemplated action. I don't know what the fact is.

Mr. Lauritzen: Could you find out this, Mr. Reinhardt, whether the SEC wasn't fairly familiar and conversant with the facts that Fidelity was using these booklets, Exhibits 85-87, after the injunction decree?

Mr. Reinhardt: Mr. Jaegerman could do it for you.

Mr. Jaegerman: I would say the Commission was not at all conversant or familiar with the type of booklet the company was using. The Commission had the assurance of the company that a registration statement was in course

[fol. 2634] of preparation and would be filed in time, and then, of course, only an official prospectus might be used, and prior to the filing of the official prospectus the SEC doesn't examine any prospectus. If it were called to our attention that it was a gross abuse, we might go in and enjoin it or prosecute it criminally. I don't know whether it was ever brought to our attention in that manner. Certainly it was not brought to my attention.

The Court: The evidence will be admitted only so far as it shows that the company, through its president, was informed that Mr. Koontz had the conversation that the witness said he was informed that Mr. Koontz had. It seems to me that has very little bearing on the case, but it will be admitted for the limited purpose.

Cross-examination.

By Mr. Farmer:

Q. Mr. Risley, the company, you said this morning, in response to the Judge's question, in your opinion, probably could not successfully operate under the Investment Companies Act of 1940—that is, this new Federal Investment Companies Act—and lay aside its reserve to be ac-[fol. 2635] cumulated at the rate of 3½ per cent per annum compounded semi-annually, without appropriating to income—compounded annually, Mr. Reinhardt said.

A. I think that is correct.

Q. (Continuing.) Without appropriating to income sums paid in by contract holders who lapsed their certificates or who don't pay enough payments to have any surrender value?

A. I don't recall that.

Q. Well, I thought that was——

A. No, my statement was that the Investment Companies Act of 1940 required the creation of what they termed in the Act as deficiency reserve, if in the past the company had created reserves requiring a greater improvement rate than 3½ per cent. The association was not financially able to create these deficiency reserves which would place the reserves behind each and every contract outstanding on a 3½ per cent basis.

Q. Yes, sir, I understood about that deficiency reserve, that they would be required to do that, but I thought that

you also, in response to a question by his Honor, said that [fol. 2636] you were doubtful that the company could operate and continue to do business under the Investment Companies Act of 1940 and accumulate reserves on the basis of 3½ per cent compounded annually.

A. If a hundred per cent of the contracts went to maturity, I think. Is that the question you are referring to?

Q. All right. Maybe that was the language he used. If a hundred per cent went to maturity, you could not do it?

A. No.

Q. Your experience has shown that quite a large percentage of contracts are not paid to maturity?

A. That is correct.

Q. As a matter of fact, from 91 to 93 per cent of the people who purchase those contracts do not pay them to maturity, according to the studies made by the Securities and Exchange Commission?

A. According to their study, yes.

Q. And the Securities and Exchange Commission found, and reported to Congress, that the company was only able to operate—"has been only able to operate in the ten year period 1927 to 1936 by appropriating to income sums paid in [fol. 2637] by people who buy the contracts and who either cease paying before the contracts have any surrender value or who withdraw their surrender value before that value has equalled the sum of the amounts they have paid in."

The Court: Mr. Farmer, that is not a fair statement of the question. I don't think it has been indicated by this witness that the company appropriated anything. You imply by your question that the company had to take money that belonged to some contract holder, and I don't believe that has appeared in evidence at all.

Mr. Farmer: I submit, if the Court please, that my question was absolutely accurate and fair. I was basing it on the report of the Securities and Exchange Commission, and I read from that report——

The Court: You are supposed to be basing it on a statement made by this witness.

Mr. Farmer: Well, I didn't, if your Honor please.

The Court: Let's hear the question.

(The question was read.)

The Court: In that question you are asking this witness to say what is in that booklet, and I think the question is

[fol. 2638] objectionable from that viewpoint, because the booklet is in evidence and the Court can see what is in it.

Mr. Farmer: Well, that is what it says.

The Court: Then don't ask this witness what it says.

Mr. Farmer: My purpose was this. I wanted to show by this witness that the Securities and Exchange Commission investigated these companies, and this one in particular, and found that that was the way it was able to operate in the past, and I wanted him to go with me just one step further, and say that would be the only way it could continue to operate in the future.

The Court: Well, ask him that.

Mr. Farmer: Well, I was just leading up to that, and I would like to get him to agree with me up to the present.

The Court: It is not necessary for him or anybody else to agree with you as to what is in that book.

Mr. Farmer: You wouldn't disagree with me?

A. I would.

Q. You would?

A. And I have.

[fol. 2639] The Court: Let's go ahead with proper questions and not encumber the record with too much extraneous matter.

Mr. Farmer:

Q. You mean that you do not agree that the association was able to continue in business in the past by appropriating to income a large amount of installment payments in the early months after the issuance of the certificates?

A. It all depends on the meaning you place on the word "appropriated."

Q. Appropriated?

A. Yes.

Q. I mean they used it.

A. The Fidelity Investment Association never appropriated or confiscated one dollar of the accumulated reserve behind a contract while I was with them. Other companies in this type of business did, and not knowing what portion of the report you are reading, it sounds to me as though it covered the report on another company, not Fidelity.

Q. Well, this is on Fidelity, page 100.

A. As you may know, Mr. Farmer, the contracts of Fi-

[fol. 2640] delity provide a definite and fixed amount as an expense allowance, gross, of course from each payment that is made thereon, and in my seventeen years with the company that is the only money that was ever applied to the profit and loss account of the association from the payments made by contract holders.

Q. Don't you understand that this is what they mean, Mr. Risley, and isn't this a fact, that this is what is involved in the operation of the company—has been involved—that a large percentage of the people who buy the contracts, as you have just agreed with me, don't continue their payments long enough for the contract to have any surrender or reserve value, and then there are other people, in quite a large percentage, who withdraw their surrender value before they have paid in enough so that the surrender value equals what they have paid in?

A. That is correct.

Q. So that those people do lose money?

A. No question about it.

Q. They lose it. That is right. And somebody gets that money. They lose it, so what is their loss is somebody else's gain? Isn't that right?

[fol. 2641] A. It might be considered that way.

Q. Who gains from it?

(No answer.)

Q. The company?

A. Under the Fidelity plan the company would make more money from the contract holders that completed their payments than those that discontinued in the early part.

Q. You mean the company had to take that money and use a part of it to pay these old matured contracts, didn't it?

A. No, sir.

Q. Isn't it a fact that on these old maturing contracts that have been outstanding and paid up, that over this ten year period 1927-1936, the amount paid out by the company exceeded the amount that was paid in on those contracts?

A. That is probably true, but it is not income from the association that was used. Remember that in the creation of these reserves securities are purchased, and then when the maturity payments exceed the income, then it is up to the association to sell those securities that they have in the reserve to meet the maturity payments. You don't

[fol. 2642] have to touch the income of the association in any way, shape or form to pay out those contracts.

Q. But your company was established on this principle, and worked on this principle, that it was an essential feature of it that there were people, a large percentage of these people paid in their money, and they lost—lost all they put in.

A. The company was not established on that premise.

Q. Well, I say that was an essential feature of the operation of the company.

A. No, sir.

Q. Well, that happened—that did happen.

A. It happened, yes.

Q. It happened because under the contract they didn't get their money back unless they paid so much in such a length of time.

A. That is correct.

Q. So they lost what they paid in.

A. They lost a part of what they paid in.

Q. And if the company had not been able to retain those sums of appropriate them, as the SEC said, they would [fol. 2643] not have been able to operate as long as they did.

A. I am afraid you are mistaken there, Mr. Farmer. The actuaries that prepared our contracts created a reserve on such a basis that 100 per cent completion was contemplated. In other words, not one single contract had to default or discontinue its payment in order that the contracts might be paid in full.

The Court: Let me ask you this, Mr. Risley, and see if we can clear up this matter. When a contract was sold it was necessary to pay the commission on that contract, which was relatively large in proportion to the first annual payment.

A. Yes, sir.

Q. And it was also necessary to incur such other expenses in connection with carrying that contract, which, together with the commission that was paid out for selling it, as I understand, took up all of the first year's payments under your old contract, or substantially all.

A. Substantially all, yes.

Q. Now, if that contract ran on for the other nine years of its life the expenses to be charged against it were not [fol. 2644] very high?

A. No, sir.

Q. Was any more commission to be charged against it after the payment of the first?

A. No, the salesman received his commission, generally speaking, out of the first eight monthly payments. You see, the majority of our business was sold on a monthly payment plan, not on an annual payment basis; and then, following that, there was a fixed expense allowance from each monthly payment to cover the operating expenses of the association as long as that contract continued in force, and then under the proper management that allowance was sufficient to permit a profitable operation each month on that contract, and that is why I say that the association made more money—Fidelity Investment Association made more money on contracts that ran to maturity than those that discontinued in the early part.

Q. As I understand, then, on the contracts that were discontinued, the Association was protected against loss—against actual loss—by the fact that a greater percentage could be allocated to expense in the earlier years, but it [fol. 2645] would have got more profit had those contracts been carried to maturity.

A. Your Honor, there is a question that the association may have lost money on some of the contracts that were discontinued after one or two or three monthly payments. In other words, the cost of establishing the records suitable for 10 or 10½ years exceeded the net expense allowance above the sales commission to the association, so that I unhesitatingly say that the association did lose money on some of the business that was sold with only two or three monthly payments.

Mr. Jaegerman: And another source of great actual loss along that line, your Honor, would be what Mr. Risley has called deferred commissions advanced. Isn't this right? The company, in the past, at least, would make very substantial advances to the salesmen or sales agencies on these contracts on which two payments had been made—it would advance the commission assuming the balance of the payments would be made, and when they were not made that caused enormous loss.

The Witness: That was what caused our loss to the National Sales Agency.

[fol. 2646] Mr. Jaegerman: And that amounted to over a million dollars, didn't it?

A. That is correct.

Mr. Farmer:

Q. You say the company may have lost money on some of those contracts that they did not continue?

A. That is right.

Q. One thing is certain, that those people that took out those contracts lost money, didn't they?

A. Yes, sir.

Q. And the SEC reported that the overall loss to surrendered certificate holders for the ten year period was $6,010,000, didn't it—page 109?

Mr. Huwe: I object and move that it be stricken.

The Court: Sustained. The Court is not going to permit any more reading from that book and asking witnesses whether that is in the book.

Mr. Farmer:

Q. Well, do you agree with that?

The Court: Objection sustained.

Mr. Farmer: I am on this point, if the Court please. Here is what I am leading up to and here is the unsoundness, as I see it—I may be all wrong about it—here is [fol. 2647] the unsoundness of this company and this type of companies.

The Court: I think I understand exactly your theory.

Mr. Farmer: Would your Honor state it?

The Court: It is that many, a great many, contract holders pay in money for their contracts which they never get back. Isn't that the whole of your theory?

Mr. Farmer: That is the first step, and the second step is that the company thrives on that, that but for that fact the company could not continue, as the SEC found. That is a very important factor in the operation of these companies.

The Court: Well, I think that the Court understands that that is true, but it is due to the fact, as has been brought out by this testimony, that commissions must be paid out of early payments, the first payments, and that certain other expenses must be set up out of those early payments which are not necessary in the later stage.

Mr. Farmer: Exactly. The poor man pays the salesman 18.9 cents of every dollar that he pays in that company and [fol. 2648] loses. The salesman gets 18.9 cents of it to

pursuade him to put his money in and lose it in the company.

The Court: Of course, we have got to take into consideration the fact that that same thing would be true if he took out insurance.

Mr. Farmer: But not buying a Government bond, if your Honor please.

Mr. Palmer: If your Honor please, may I make this suggestion, something that is in the minds of both the Court and Mr. Farmer that has not been expressed, that there is, in addition to these legitimate expenses of paying salesmen's commissions and paying the expenses of the company from the payments during the early part of the life of the contract, that every lapsed contract, be it early or late, or surrendered contract, represents an actual profit to the company, and that is what Mr. Farmer is bringing out, that regardless of the fact that expenses and commissions are incurred, that there is a real and actual earned profit going into the company, and that that is what the report he is reading from has reference to.

[fol. 2649] The Court: That is what I was asking this witness, and this witness says that while that is true there would be a better profit had the contract not lapsed but had been carried on to its maturity. That is what I understand his answer to be.

Mr. Farmer: I would like to read your Honor something that has not been read and is not in evidence. It is the finding of the Securities and Exchange Commission on these companies in another part of their report to Congress, Part 2, page 228, this paragraph on that particular, and it says this——

The Court: Just a minute. The reporter is taking this down. I don't want any more books read into the record.

Mr. Farmer: I don't care whether this goes in the record or not.

The Court: All right.

(Mr. Farmer read, off the record, from the book referred to.)

Mr. Farmer:

Q. Do you agree with this, Mr. Risley, that in order for a company to have a chance to operate under this Investment Companies Act requiring the accumulation of re-

[fol. 2650] serves at 3½ per cent compounded annually, it would be necessary to treat as income the payments paid in by the certificate holders who lapsed or surrendered their certificates before the surrender value equals the amount paid in?

A. It would be necessary for what purpose?

Mr. Farmer: Read the question.

(The question was read.)

A. That is a mighty difficult question to answer, because there are so many factors to be taken into consideration. If in designing the certificate to be sold under the present Act the loading was sufficient, and the management expenses were kept within that loading, it would not be necessary at all to rely on lapses or forfeitures or discontinuances. On the other hand, if the loading was placed low and calculations made as to the possible number of delinquencies, then it would be necessary to depend on that source.

Q. Well, is this not true, that the ratio of commissions paid out to salesmen to the installments paid in has been constantly rising? Hasn't that been the experience in the operation of this company?

[fol. 2651] A. There has been very little change in our company since 1932.

Q. Well, you don't agree with the SEC that reported that?

Mr. Warner: I object.

The Court: Sustained. We don't care whether this witness agrees with the SEC or not.

Mr. Farmer:

Q. Well, did you ever figure it up to see?

A. The difference, you mean, between the commission paid in 1934——

Q. To see whether it costs them more or less to sell these certificates?

A. The rate of commissions has never changed.

Q. I know, but the cost—the total cost—of selling has greatly increased, hasn't it? I mean, it has become increasingly more difficult to sell them?

A. I think you are right on that.

Mr. Farmer: Yes, that is what I am getting at. That is all.

Mr. Palmer: May I ask one or two questions, your Honor?

[fol. 2652] Examination by Mr. Palmer (resumed):

Q. Mr. Risley, isn't it a fact that the fundamental selling principle of the contract of this kind, particularly here in West Virginia, was that for every dollar of contracts sold there would be one dollar deposited with the state officials of the State of West Virginia which would be available to that contract holder in the event of any failure of the company?

A. That is not—not quite true, Mr. Palmer. The sales presentation was based on the fact that we would deposit with the State Treasurer of West Virginia 100 per cent of our cash liability on that contract, not for every dollar that was paid on it.

Q. Yes, you are correct. And that that fund would be available and under the control of the State Auditor in the event of any liquidation of the company? Wasn't that your selling point?

A. That was the selling point, yes.

Q. And wasn't that the point upon which you attempted to recruit or to sell to your salesmen the idea of becoming salesmen?

A. That point was used both in selling contracts and [fol. 2653] recuiting salesmen.

Q. Will you tell us whether or not an appointment for a conference with the Securities and Exchange Commission this year that Mr. John Marshall didn't want you to fulfill, and if so will you explain it?

A. Yes, I had an engagement with Mr. Carter of Mr. Schencker's division.

Q. Will you explain what Mr. Marshall's position was on your having that conference with——

A. I don't know just exactly what was in Mr. Marshall's mind, but he didn't want me to keeep that appointment; he wanted me to just ignore it.

Q. And when was that?

A. It was some time, I would say, in the month of March.

Q. Of this year?

A. Of this year, yes.

Q. It is true, is it not, that what you have related about the inducement of the state securities law of West Virginia was the same inducement used in other states as well as West Virginia which had a similar or somewhat similar law?

[fol. 2654] A. I believe that was used, yes.

Q. And that included Illinois?

A. In recent years only, because——

Mr. Farmer: If the Court please, before we adjourn I have got a motion I would like to make about this meeting tomorrow. I would like to have about five minutes for that.

Mr. Palmer:

Mr. Risley, in your hearing before the SEC in January, 1938, isn't this a question that was asked you and an answer that was given:

"Question: Now, that 10 per cent figure that you gave us, what is that?

"Answer: That was my estimate as to the probable amount of maturities. In other words, there was 90 per cent that was terminated in some other manner than going all the way through to maturity."

Do you recall that question and answer?

The Court: It is the same answer he makes now, Mr. Palmer. He says now that at least 10 per cent carried——

Mr. Palmer: I was trying to get that "at least" off, your Honor.

[fol. 2655] The Court: All right; if you can get that off, all right.

A. Well, of course I remember being there at that hearing, but I do not recall what I said at this time verbatim.

Mr. Palmer: May I show you the copy I have of the official report of the proceedings before the Securities and Exchange Commission by the Electreporter, Incorporated, official reporter, the question being on page 21637 and the answer on the same page, and ask you if you would say that you did not make that answer to that question?

A. I believe that that is correct as reported.

The Court: Now, Mr. Farmer has said he has a matter to take up, so I think we had better outline a little schedule for Mr. Risley in his subsequent testimony.

Mr. Palmer: I have several other questions here, your Honor, that I could finish in about three minutes.

The Court: I will give you three minutes, then.

Mr. Palmer:

Q. Mr. Risley, isn't it true that in answer to this question at that same hearing you said:

"Question: Mr. Risley, you say that the Virginia statute [fols. 2656-2669] requires——

"Answer: West Virginia.

"Question: The trustee holds funds for the benefit of certificate holders.

"Answer: Yes.

"Question: So that in the eventuality of any financial difficulty of Fidelity, it would have to be voluntarily or involuntarily liquidated, that pool of money, you say, unquestionably would go to certificate holders before your general creditors could come in?

"Answer: Yes, that is my information."

Did you give those answers to those questions?

A. I am sure I did.

Q. Isn't it true that at that hearing you said the normal turnover of your sales staff was approximately 80 per cent?

A. I believe so.

* * * * * * *

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[fol. 2670] Carroll D. Evans called as a witness by the state court receivers, having been duly sworn, testified as follows:

Direct examination.

By Mr. Palmer:

Q. State your name, please.

A. Carroll D. Evans.

Q. Where do you live, Mr. Evans?

A. Wheeling.

Q. Were you formerly connected with Fidelity Investment company?

A. I was.

Q. For how many years were you connected with that company?

A. About seventeen.

Q. From what period until what period were you connected with it?

A. April '23 to May '41.

. . . . . .

[fol. 2671] Mr. Palmer:

Q. Mr. Evans, what position or what part of the organization did you start with?

A. As a salesman.

Q. Will you tell us the various and successive positions you held with the company and the approximate time at which you made the changes?

A. I got the first part of the question but not the second.

(The question was read.)

[fol. 2672] A. I was a salesman in Pittsburgh for sixty days in the early part of 1923. I was thereupon made manager at Washington, D. C., where I was located for approximately two years. Thereafter I was more or less of a home office employee in the field, visiting various offices, for a period of I would say five years. Thereafter I was put in charge of Western Pennsylvania, Eastern Ohio, the State of West Virginia, and any southern territory which might have been open at that time. In February 1935 I was made director of agencies and continued in that position until May 1940.

Q. You said earlier, I believe, that you were connected with the company until '41?

A. I want to change that It was '40.

Q. Were you ever a member of the board of directors?

A. Yes, sir.

Q From what period?

A. As near as I can recall, I was elected to the board shortly after I became director of agencies in February 1935.

Q. And when did you cease to be a member of the board of directors?

[fol. 2673] A. It was either in April or May 1940.

Q. Mr. Evans, in your relations with the company did

you become thoroughly familiar with all of the selling aspects of this company?

A. I tried to become entirely familiar with all the selling aspects.

Q. Mr. Evans, what one feature, if any one, stood out above the others, and first interested you in becoming associated with the company?

A. There was one or two factors. The first one was the novelty of the plan. The second was the—I would say the West Virginia law, which required 100 per cent of the outstanding liabilities to be deposited through securities.

Q. With reference to that second——

A. I might augment that, but I felt that there was a great possibility for a career in the business, based on what I had observed up to that time.

Q. With reference to the feature of the West Virginia law, during the time that you were actively a salesman, did you stress that feature to the persons to whom you were attempting to sell contracts?

[fol. 2674] Mr. Ray: May it please your Honor, I don't see the relevancy of that. I object to that line of questioning.

The Court: Overruled for the present.

A. That was one of the features, Mr. Palmer, that was stressed.

Mr. Palmer:

Q. Now, Mr. Evans, will you tell us the sales condition of the company at the time you took charge in 1935?

A. Well, the sales condition of the company is, I think, most—could be most accurately reflected in the volume which was being produced at that time, and as near as I can recall it was on a basis of about one million or slightly over monthly.

Q. One million of what?

A. Well, that is face value—total face value of contracts sold.

Q. That was about the volume being produced monthly when you took over?

A. Slightly over a million dollars monthly.

Q. What was the setup that had existed just before you took over with reference to selling? How had the company

[fol. 2675] organized that, or what was the principal setup of it?

A. Personnel?

Q. Personnel and the organization. How did it work and how did it function?

A. My predecessors, of course, had charge of sales for the whole company. He had three supervisors as his assistants in the field, and under those supervisors and the director of agencies operated the various offices and the management of those offices and the salesmen.

Q. About how large an organization was there?

A. The organization was slightly over 400 registered representatives in the field.

Q. And what principal offices were there with reference to regional or state districts?

The Witness: Will you read that?

(The question was read.)

A. The principal offices at that time were Chicago, Philadelphia, Milwaukee, New York. There were at that time approximately 20 offices. I am giving you the four, as I recall, who were the leaders in volume at that time.

Q. And there were about 20 offices?

[fol. 2676] A. Yes, sir.

Q. Now, Mr. Evans, will you outline to the Court just what your procedure and plan was and what you carried out in the way of attempting to organize the sales end for selling purposes?

A. Because of the volume being comparatively low, the company was not then operating at a profit. In order to operate at a profit obviously it was necessary to increase the volume. The relationship between volume and profit is, of course, obvious, but in order to arrive at profit in the personal sales field you must have volume, and in order to acquire volume you must have representatives. The more representatives you have therefore the more volume you will have, and your profits will be correspondingly greater. With that as a basis I started a recruiting campaign having as its first objective a monthly volume of two million and a half, which, when acquired, it was assumed would have the outgo meet income.

Q. Had you been informed of that by the company officials?

A. Not by the officials. I think it was one of the statisticians who gave me that figure, as close as he could get it. [fol. 2677]

Q. When you say you started a recruiting campaign, perhaps the Court is not thoroughly cognizant of what you mean by that.

A. In the recruiting campaign you bend every effort to interest men in the business, train them and get them into production, and we put on a rather intensive campaign, because we wanted, as quickly as possible, to acquire volume which would put the operating end of the company on a profitable basis.

Q. When you reached the figure of two and one half million, then what did you discover?

A. We continued our recruiting and training—intensified the training.

The Court: Let's suspend a minute.

(There was a discussion off the record.)

Mr. Palmer: Will you give Mr. Evans his answer?

(The answer was read.)

A. For a period—the plan was based on a four year program, with an objective of more than five million volume, a month, and we were able to make that objective at a later date. [fol. 2678]

Q. Mr. Evans, it has been brought out in evidence here that the company had pretentious and somewhat expensive sales offices in the various cities. Will you tell us whether that was necessary for your selling campaign or your recruiting campaign, and if so why?

A. The usual method—we had three or four methods of getting men to the office, or rather interesting them in coming to have an interview.

Q. That is the men——

A. Prospective representatives, some of whom came from reference sfrom friends or contract holders and some from newspaper replies and any other method whereby we might interest prospective——

Q. Before you answer my other question fully, will you explain to the Court what method you tried to interest prospective salesmen?

A. The bulk of them came from newspaper advertising, although our better salesmen came from those referred to us by contract holders or by friends.

Q. Now, will you proceed with your explanation as to why the pretentious offices were needed.

[fol. 2679] A. The offices, in the first place, were not all pretentious. We had some very modest offices. We had a number of offices where the office expense was less than $50.00 a month, but in the larger centers where our supervisors were located we had more pretentious offices. It was in those centers where we had the greatest number of men, and we, of course, wanted to give the proper window trimming to the prospective salesman, the same as you might expect a guest to come to the house you would want to receive them in the best style. Well, it was necessary in these offices to have a space known as an assembly room, where morning meetings were held, instructions were issued, educational plans were carried forth. Sometimes those rooms had to have a capacity of a hundred seating capacity. But on the whole the offices were—we made an attempt to make the offices as presentable as possible.

Q. That was to put your best foot forward to the prospective salesmen to show them the type of company, to impress them with the fact that it was a good company, and in order to do that it was necesary, as you say, to put some window dressing up?

[fol. 2680] A. Yes, sir.

Q. Now, with reference to some of the salesmen and sales managers making from ten to twenty-five thousand dollars a year, was that necessary as window dressing in any way?

Mr. Ray: May it please your Honor, I don't remember any evidence of that.

Mr. Palmer: Mr. Evans will give the evidence.

Mr. Ray: Your question is based on evidence already in, Mr. Palmer.

The Court: I think it would be better to establish whether that was a fact before you ask him whether it was necessary.

Mr. Palmer: All right, your Honor.

Q. Mr. Evans, did any of the salesmen make from ten to twenty-five thousand a year, or sales managers?

A. They did.

Mr. Palmer: Now, will you read my question?

(The second preceding question was read.)

A. It wasn't necessary as window dressing, but it was very helpful.

Q. In what way? Will you explain to the Court?

[fol. 2681] A. Well, if you have a prospective salesman being interviewed this morning and you can point to someone who has been in the office a period of four or five or six or seven years who had also started as a salesman and what at the moment was making from five to ten thousand dollars a year, that should be very appealing to man out of a job and seeking a career in the sales field. As such it was very valuable information.

Q. Mr. Evans, tell us whether the cost of recruiting was high or small and what percentage of men you could get whom you interviewed and so forth.

A. As near as I can average, based on past experience, you would normally interview about a hundred men in order to recruit ten, and of the ten recruited ordinarily you would not find more than one who was able to produce an acceptable volume of business.

Q. Now, Mr. Evans, was it necessary for you or those under you at the home office to prepare literature for this recruiting of salesmen?

A. Yes, sir.

Q. And did you prepare that?

A. Personally I have assisted in that. It was done mostly [fol. 2682] by the sales promotion department.

Q. And was it done as a constant and steady thing, new literature going out at frequent intervals?

A. That is correct, making whatever improvements we could in the field as time went on.

Q. What, if anything, was done with reference to spending on newspaper or other forms of advertising for recruiting purposes only, I am speaking of?

A. That was an expense that was borne by the district managers and the supervisors for the most part.

Q. Was there some newspaper advertising and other advertising?

A. We had some newspaper advertising under the head of a national advertising campaign that was institutional advertising at the time.

Q. Under your supervision you started out with 20 offices, and I think you said about 400 men. Will you tell us whether you expanded that, and if so in what period of time and to what extent?

A. From February 1935 for a period of five years, approximately, that sales force was expanded from 400-odd men to more than 1800 representatives in the field. The [fol. 2683] offices were increased—branch offices instead of from about 20 to in the neighborhood of 60, as I recall, and we operated in 20 states at the end rather than the 17 which we were operating in when I took over.

Q. Now will you develop for us a little more fully, Mr. Evans—you said it was necessary to have volume in order to make a profit. By that do you mean that there were certain fixed expenses and that the proportion of volume increased to extra expenses is in lesser ratio, and that therefore the greater the volume the better the chance of making a profit?

A. That is correct; your administrative expenses remain practically constant regardless of the amount of volume. However, when you increase your volume you decrease the ratio of administrative expenses to the volume.

Q. When did you reach your peak of selling under your administration, Mr. Evans?

A. I think it was in November—would you mind if I refer to my——

Q. No, I would be glad to have you refer to any data that you have.

A. It is just a matter of dates. (Witness refers to [fol. 2684] papers.) The greatest volume attained in any one month during my office period was in September 1938, when we reached a volume of $5,601,200.

Q. That is face amount?

A. Face amount—total face amount of all contracts sold.

Q. Mr. Evans, would you say that from the time you took charge there had been a gradual but steady increase up to that figure?

A. Yes. Well, in the main it was. In 1935 the total volume for the year was $16,447,950; in 1936 it was $25,513,800; in 1937 it was $40,[illegible]8,750; and in 1938, $52,450,150. There might be some slight modifications of those figures, but they would not be very far off.

Q. Mr. Evans, what can you tell us as to whether or not the SEC suit in Detroit in December of 1938 had any effect upon your sales and whether the following receivership proceedings in the Northern District of West Virginia United States District Court had any effect upon your sales.

A. The sales volume, Mr. Palmer, in November of 1938 [fol. 2685] was $4,790,600, and in December, when the SEC proceedings took place, the volume was $2,958,450. In January—during January and February there was no volume.

Q. No volume at all?

A. That was in 1939. In March there was a volume of $750,000, and that continued up until March 1940.

Q. What was the peak month after the SEC suit, and the amount of it?

A. August 1939 $1,505,700.

Q. Was there any other month over a million?

A. Yes, sir.

Q. Will you just give us those months, without the figures?

A. From 1939, June, July, August, September, October, November, December and January of 1940, fell below a million, and the same applied to February and March of 1940.

Q. Mr. Evans, I don't think I asked you what part the sales room played, if any, that you had in your various cities with reference to helping those salesmen whom you recruited sell their prospective customers. Did that play any part in your sales, the fact that it helped to recruit sales- [fol. 2686] men?

A. No, not to any extent. Sales were mostly made in the field. Very seldom did any sale occur in the office.

Q. Mr. Evans, it has been said here in evidence that the sales force had an approximate turnover of 80 per cent or thereabouts per year. Can you give us any help on those figures?

A. I think that is a conservative estimate, Mr. Palmer. I think 80 per cent is very conservative. I think it would be a higher percentage of that, if a calculation were made.

Q. This has also been stated here, Mr. Evans, that approximately 15 per cent of the sales force produced the greatest bulk of your sales.

A. I think that is approximately correct.

Q. And about 10 to 15 per cent produced about what percentage of your total sales?

A. I would say between 70 and 80 per cent of the totals.

Q. It has been suggested from the witness stand here, Mr. Evans, that since 10 to 15 per cent produced the vast [fol. 2687] majority of your sales, that the thing to have been done by the sales end was to fire the other 90 to 85 per cent and you would have gotten along without such big offices and without such expenses and gotten along better. What can you tell us about that?

A. If the 10 or 15 per cent of your top rank salesman would continue on indefinitely as a permanent part of your organization, that would be a very fine solution to the problem, except for the fact that the 85 or 90 per cent of the salesmen producing 25 per cent of the volume, if you took those all off it would result in a loss of 25 per cent of the volume, for example, and a proportionate amount of the profit. A sales force in the personal sales field is an everchanging sort of thing. You have new leaders every month or so. Nothing remains constant. In order to attain a production figure, it is necessary to continue to recruit to the best of your ability in order to retain numerically a large number of salesmen. You can never tell when one who is in the lower bracket, below the 10 or 15 per cent, might suddenly become a star producer. Therefore, it is awfully hard, a very difficult matter, to say, "We will just shut off that 90 per cent [fol. 2688] and go on with the 10 per cent". That would be a disastrous thing, I am afraid.

Q. Isn't it also necessary to have this other 90 per cent in order to develop the 10 per cent that is good? Don't your star salesmen come from your entire group?

A. Oh, yes, that is true.

Q. Is it possible for you or any other man to recruit salesmen on the basis of background, appearance, and so forth, and to interview a prospect and say this man will be one of the ten per cent and this man will be one of the 90 per cent?

A. No, you can't do that.

Q. Is it necessarily a question of trial and experience in order to find out who are the good ones?

A. That is correct.

Q. And those good ones either go on up to higher positions with the company or go with some other company? Isn't that also true?

A. That is true.

Q. So that you have to continually be picking out a group and sifting them down and trying to find the hidden gems [fols. 2689-2700] in the large group?

A. That is, if you want to increase your volumes and profits that is necessary. If you want to be satisfied with a very small volume, your expense of recruiting could be cut down to a minimum, and your volume would be reduced and your profit would correspondingly be reduced.

Q. On the average, Mr. Evans, how many men would you have to interview to be able to finally get down to one of those men who belong to this group of 10 per cent of good producers? What would be the group number that you would start with?

A. It is a very general formula, Mr. Palmer, but I would repeat that in order to get one acceptable producer you would have to interview 100 men. Out of the 100 you would normally recruit 10. I don't know whether that would apply today or not, with the changed conditions, but it ran about that average. Now, I do not mean to say that the one who became a producer became a star producer, but out of that group be would very likely—more likely than out of the other group.

. . . . . .

[fol. 2701] Q. Now, Mr. Evans, it has been stated here that there was a large group of salesmen just waiting for [fol. 2702] Fidelity to be reorganized so that they could again go into the field and sell. Do you know of any such group as that?

The Court: I don't think it was a group; a number.

Mr. Palmer: A number would be a better word, yes, sir.

A. I don't know that there is any large number of men waiting , return, from my own personal observation.

Q. If you knew of any, wouldn't you be attempting right now to get them into your present campaign that you are working on?

A. Yes.

Q. Do you know of any former salesmen who are just taking a stop-gap job in order to get back to Fidelity when it opens again, or if it does?

A. Not from my personal experience and observation.

Q. Do you see and contact a number of former salesmen of Fidelity in the City of Wheeling?

A. Not a large number, because there are only a comparatively small number in the City of Wheeling, Mr. Palmer.

Q. Do you know of any salesman who is waiting for Fi-
[fol. 2703] delity to reopen so that he can assume his selling job again?

A. I know of none.

Q. Now, Mr. Evans, you are conversant and familiar, are you not, with the past history of Fidelity over the last twenty years?

A. In a general way, yes.

Q. Will you tell the Court whether, if Fidelity were reorganized, there would be any sales resistence because of what has taken place in Fidelity over the last fifteen or twenty years?

The Court: That is, in his opinion and his experience.

Mr. Palmer: Certainly, in his opinion, based upon his experience, of course.

A. Based on my experience, I would assume there would be increased sales resistance, because of what has transpired in connection with Fidelity.

Q. If Fidelity were reorganized, Mr. Evans, can you tell us the approximate amount of money it would take to redevelop a sales organization?

A. No, sir.

[fol. 2704] Q. Well, can you tell us the minimum amount of money it would take to develop a sales organization?

A. No, sir.

Q. Can you give us any figures at all on what it would cost to build up a sales organization?

A. I can't give you any figures. I can generalize, if that is what you want me to do.

Q. All right, sir.

Mr. Ray: Your Honor, I think that is objectionable. What kind of sales organization and what is the sales organization going to do? Unless it is limited to something that fits the situation here——

The Court: Well, if this witness in his answer, will go into that and state what he has in mind, I see no objection to the question, so go ahead.

A. In reorganizing a company, or rather a sales force, to sell the contract of a company under present conditions, as indicated by my previous testimony would be a very difficult matter under present conditions, I believe. The more difficult it is the more expensive it would become, because in order to maintain what you would call recruiting units of men set aside to recruit salesmen in order to sell [fol. 2705] your product, I think you would have to pay them either a rather sizeable drawing account to get your better men or else a salary. Now, depending upon the extent of the sales force wanted—in other words, if you had a home office setup requiring the expenditure of a certain amount of money, you would have to sell so much volume at a certain profit in order to break even. Obviously, the first day you open your shop you haven't sold anything. Perhaps an hour later you do sell one, and so on down till you develop enough volume to take care of your expenses. It is like opening up any new business, where you have to get the business in before you start making a profit.

Mr. Palmer:

Q. Mr. Evans, would there have to be a large amount of money expended in order to get offices, recruit salesmen and develop salesmen, and a loss taken on that for some time before you could expect return upon that campaign?

A. Depending upon the size of your sales organization wanted and the number of states you want to operate—the number of cities you want to operate in, whether you want to do the job on a gradual basis of starting very small [fol. 2706] and developing, or whether you want to start right in and put on a sizeable campaign immediately, would determine the profits and the period of time in which those profits or losses will take place.

Q. You said it took 1850 men to produce a sufficient volume so that Fidelity could operate at a profit during the——

A. No, I didn't say that, Mr. Palmer.

Q. How many men did it take, approximately, Mr. Evans?

A. There was a profit—as I understand—I won't vouch for these figures, because they would have to be checked. A small profit in 1936 from operations, something like $14,000, I have it here; and at the end of 1936 we had 766

in the organization, of whom 352 were producers. In other words, 352 men producing enough to meet the expenses as of that time. That is very approximately.

Q. Mr. Evans, will you give us, as best you can, from your experience and judgment, what it would cost to build a sales organization up to that figure that you had at the end of 1936?

[fols. 2707-2712] A. I have not the slightest idea.

Q. Well, could you give us what you figured the cost per man to train a good salesman?

A. I haven't figures on that, but it is again a sifting out or weeding out process. Coming back to my original illustration of 100 men interviewed in order to get 10 who would start to work, in order to get one who would become a producer, the cost would be considerable. It could easily be a couple of hundred dollars per man. I mean per producer—per outstanding producer.

Q. And that is when you have already got your recruiting setups in existence. Now, if you had to build that recruiting setup, would it double that figure of a couple of hundred dollars per man or not?

A. Well, it depends on volume. That recruiting setup would be absorbed from the income or profits the salesmen made. I wouldn't know whether——

. . . . . .

[fol. 2713] Mr. Palmer:

Q. Mr. Evans, is it your opinion that if Fidelity were reorganized it would do better by being reorganized as a life insurance company or as a face amount securities company?

A. I think it would fare very much better as a life insurance company.

Q. With that answer in mind, would it fare better in operating as a reorganized company of Fidelity, or would it fare better in being taken over by another reputable life insurance company and run as a part of it?

A. My opinion, which might not be worth anything in this case, because I have confined myself to sales work and not reorganization, would be that because of the fact that any [fol. 2714-2723] life insurance company which might take over the assets of this concern, already having an administrative setup and sales setup, branch offices, et cetera, would

be in better shape to administer the service—that is what it is going to be for some time, I think, service to these contract holders than a concern which would have to be reorganized from the ground up.

Q. So that your answer would be that if it were to be a life insurance company, it would be better that it be taken over by some other operating company?

A. I think so.

[fol. 2724] Q. Then for the most part these ten to twenty-five thousand dollars a year men were paid from commissions which resulted from their work?

A. That is right.

Q. In your opinion, did these men who received large remuneration earn what they received?

A. Yes, sir. When I say—might I amplify that?

Q. Yes.

A. When I say earned it, I mean to say they are men greatly experienced in organization work, and they were able, because of their experience, to develop a sizeable [fol. 2725-2727] enough sales force to pay them rather handsome returns, whereas one less experienced—and we had those in the organization too—couldn't make that much return.

* * * * * * *

[fols. 2728-2733] Q. Having in mind the best interests of the contract holders, can you answer this question, should the company be liquidated or reorganized?

A. I can't answer that question.

Q. You can't answer that question?

A. No, sir.

[fol. 2734] Mr. Lauritzen:

Q. Mr. Evans, we had some discussion last evening. Didn't you at that time tell me that $500,000 would not be an out of the way figure as a minium amount that would be required for that purpose?

Mr. Ray: I object to that, your Honor.

The Court: Overruled.

Mr. T. C. Townsend: That is a basis for contradiction, I guess. Will you contradict him?

Mr. Lauritzen: I am just trying to bring out what the facts are if I can, Mr. Townsend.

Mr. T. C. Townsend: I just wanted to find out your attitude.

The Witness: May I have the question?

(The question was read.)

A. That is correct.

Mr. Lauritzen: Mr. Evans, after the SEC proceedings you testified that the company's business for several months [fol. 2735] fell to nothing, and I believe your testimony was that it never did revive up to anywhere near the volume to which it had been built before the SEC investigation and injunction. I am correct in that, am I?

The Witness: Your question, please.

(The question was read.)

A. To what it had been immediately preceding that time —the volume immediately preceding that time. We had volume in 1939, after the SEC investiagtion, which was comparable to the volume back in for example 1935.

Mr. Lauritzen:

Q. And what volume was that in dollars, Mr. Evans?

A. For 1935?

Q. No, the highest figure to which you built after the SEC injunction?

A. After?

Q. Yes.

A. $1,505,700.

The Court: Per month?

A. One month, yes, sir.

Mr. Lauritzen:

Q. That is $1,500,00-?

A. Yes, $1,505,700.

Q. That is the fact amount per month?

[fol. 2736] A. Yes. That was in August, 1939.

Q. That is the best you did since the SEC injunction?

A. That is correct.

Q. Didn't you testify awhile ago that when you took over the general sales management that it was deemed necessary for Fidelity to sell, first, a figure set at $2,500,000 per month,

and later a figure that you tried to build up as high as $5,000,000 a month, in order that the company could operate profitably?

A. That is right; it was approximately two million and a half per month which we were hitting at to make the company——

Q. So what sales you were successful in building after the SEC injunction, those sales were never successfully built to a point where the company could operate profitably?

A. Not on its then basis of operations.

Q. Now, Mr. Evans, considering these proceedings that we are in now and considering that prior to these proceedings there were state court proceedings in West Virginia and also in Wisconsin and Illinois and Ohio and numerous other states, can you tell us, from your experience, [fol. 2737] whether you do not believe that those proceedings will have at least as serious a result on the resumption of any possible sales campaign as did the SEC proceedings in 1938?

A. They would certainly have an effect.

Q. Do you think that effect will be as great as the SEC effect?

A. I couldn't tell.

Q. Mr. Evans, can you tell us of the contracts sold during the thirties prior to Series B, what percentage of the total gross payments on those contracts went for furnishing selling expense?

A. In what period?

Q. Sales commissions I mean. During the thirties, prior to the time you commenced selling Series B.

A. I do not have any figures on that.

Q. Do you have the amounts, Mr. Evans?

A. No.

Q. Mr. Evans, considering the fact that under the Investment Companies Act of 1940 the total loading permitted both for sales, commissions and for all other expenses is an amount equal to 7 per cent of the gross annual [fols. 2738-2739] payments on a particular contract, for instance, $84 on a $1200 contract, can you tell me whether you believe that if this company were reorganized and an attempt were made to carry on its sales activities in a manner and size comparable to those previously carried on, whether those sales activities could be carried on on that loading?

A. They might possibly be carried on, but they most certainly would be curtailed.

. . . . . .

[fol. 2740] Q. When you were head of the sales department would it have been easier for you or harder for you, speaking of you as the head of the department, to recruit salesmen had you reduced the amount of commissions you paid?

A. Obviously it would have been more difficult to recruit [fol. 2741] salesmen with reduced commissions.

Q. Would you have been able to sell a greater volume or a less volume of face amount contracts had you reduced the commissions to the salesmen?

A. Based on my previous testimony, when you reduced the recruiting activities, therefore it would reduce your volume.

Q. Now, had the company reduced the amount which it would have given at maturity to a contract holder, would that have increased or reduced your volume?

A. Depending upon factors of time and payments—monthly payments—it would reduce the appeal.

Q. Keeping all other factors the same and reducing only maturity amount, would that have reduced your sales volume?

A. I think so.

Q. Had the company, keeping other factors the same, reduced the rate of improvement on reserves, would that have reduced the volume?

A. I think so.

Q. Each one of those factors played a part in composing the whole to make your total sales? Is that correct?

[fols. 2742-2745] A. That is right; everything that detracted from the general attractiveness of the plan would certainly reduce its distribution.

. . . . . .

[fols. 2746-2747] Q. And you stressed the factor of safety, that they had a hundred per cent of safety by virtue of the deposit laws of this state.

A. That is right. And in other states, whatever the state law was.

Q. And in other states, "if you don't have a hundred per cent safety law, West Virginia has such and we have deposited the balance there to make up what your state doesn't have"?

A. That is right.

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[fol. 2748] Q. On the basis of what you now know about the improvement rate and its relation to the contract and the safety factor of the contract, would you now say that a contract with a high improvement rate is more or less at-

[fols. 2749-2758] tractive than a contract with a low improvement rate?

A. I would reverse myself on it.

Q. When Mr. Lauritzen was examining you, he brought out that you had told him last night that $500,000 would not have been an unreasonable figure for certain purposes that he specified. Have you changed your mind since last night?

A. Only to this effect, that any large sum—I spoke of $500,000, but it might have been $200,000 or $300,000, but a substantial amount of money would be required to develop the sales force to the place where we had before. I might have said $200,000 or $100,000 inadvertently in the course of conversation; it wasn't a definite opinion. I still have in mind a substantial amount of money, because I couldn't determine that.

Q. In other words, your answer now is what you testified on your direct examination, that you don't have the slightest idea.

A. That is right. There might be a variance of $500,000, $100,000, $400,000 or whatever it is.

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[fol. 2759] Tom B. Foulk called as a witness by the Tennessee contract holders, having been duly sworn, testified as follows:

Mr. Farmer: If the Court please, I desire to make this statement. I don't regard it as an altogether amenable practice to subpoena lawyers to testify, and I would not have subpoenaed Mr. Foulk and Mr. Arthur Koontz in this

case but for the fact that one of the witnesses gave some testimony which I thought made it material for them to appear here and testify as to the facts and advice that they had given their client, owing to their familiarity with many of these matters that were essentially legal matters, [fol. 2760] and it was for that reason that I reluctantly subpoenaed Mr. Foulk and Mr. Koontz to be here.

Direct examination.

By Mr. Farmer:

Q. This is Mr. Thomas B. Foulk?

A. Yes, sir.

Q. Your home is in Wheeling, West Virginia, I believe, Mr. Foulk?

A. It is.

Q. And you are an attorney there?

A. I am.

Q. How long have you practiced law in West Virginia—how long have you been a member of the bar of West Virginia, Mr. Foulk?

A. Twenty-seven years this month.

Q. Practicing all that time in Wheeling?

A. Yes.

Q. I believe you at the present time are the commissioner for the selection of juries for the United States District Court for the Northern District of West Virginia?

A. At Wheeling.

[fol. 2761] Q. At Wheeling. Without compensation, Mr. Huwe says.

A. $5.00 every time I draw a jury.

Q. Have you been connected with the Fidelity Investment Company, later Fidelity Assurance Association, in the past?

A. I have.

Q. What has been your connection with that company?

A. Well, I have been general attorney and a director during the past seven or eight or nine years, and one of the vice-presidents during a part of that time.

Q. I believe you held the position or title of general counsel?

A. Never.

Q. Never general counsel?

A. No.

Q. Just an attorney for the company.

(No answer.)

Q. General attorney?

A. Correct.

Q. And you were a director on April 10th and April 11th of this year?

A. Yes.

[fols. 2762-2765] Q. And also on June 6th you were a director.

A. I was not.

Q. You were not a director then?

A. No.

Q. Did you cease to be a director between April 11th and June 6th?

A. I think I resigned about the 27th of May, 1941.

* * * * * * *

[fol. 2766] Q. After the injunction was granted in Detroit, in December 1938, state whether or not the Securities and Exchange Commission had representatives or accountants who stayed for some period of time at the home office of the company at Wheeling?

A. I don't know of any attorneys who were there after the injunction, but during the receivership proceedings there were two accountants there constantly around. In fact, they stayed around until the receivership matter had been determined. They had some cleanup work to do, and I think that one of them, Mr. Ben Jackson, had a report that he was working on that he had to submit in order to complete his task.

Q. Do you know the name of the other?

A. Fisher.

Q. You said after the receivership proceedings. Was that different from the Detroit suit?

A. Yes.

[fol. 2767] Q. That is a receivership bill that was filed in the federal court——

A. United States Court for the Northern District, Honorable W. E. Baker, Judge.

Q. When was that filed?

A. The 22nd day of December 1938. Correct that—19th of December 1938.

Q. What date?

A. 19th day of December 1938.

Q. And when was that dismissed?

A. I am not certain, but I believe about the 9th of March 1939.

Q. And during that period you say that Mr. Jackson and Mr. Eisher were there?

A. Correct.

Q. And afterwards, did you say, or not?

A. Correct.

Q. Some time afterwards?

A. Yes, sir.

Q. Do you know about how long afterwards they remained there?

A. Well, I am pretty certain they were there in the [fol. 2768] middle of April. I remember one occasion in the April Term of court I was called from the courthouse; Mr. Jackson wanted to assure me that he was not working on any new matter, but really wanted the records to complete the old task prior to the injunction.

Q. When did the board of directors first give consideration this year to the type of proceedings or the court to which the affairs of the company were to be taken? Well, I will put the question this way.

A. I don't know just what you mean by that.

Q. State whether or not the company ceased to issue any new contracts on December 31, 1939.

A. '40.

Q. 1940?

A. That is correct.

Q. And prior to that time the charter had been amended, as the record shows, to convert the company into an insurance company?

A. That is correct.

Q. And had the directors determined to convert the company into an insurance company so that it would engage in business as an insurance company?

[fol. 2769] A. That was the action, I think, of the 31st of December, 1940.

Q. Was it the intention of the directors to convert the company into an insurance company after that time?

A. It was.

Q. When did it appear that that could not be done or that court proceedings would be necessary?

A. Well, as I recall, Auditor Sims, while he allowed licensees to issue to some of the salesmen, at the same time

had a gentleman's agreement that no business would be solicited. I think the officials went ahead to the point of having some policies printed, but no insurance policies were ever sold—no business of any sort was ever sold after the 1st day of January, 1941.

Q. Did you know anything about Mr. Sims, the State Auditor, writing a letter to Mr. Arthur Koontz with regard to his intention to take some sort of court proceedings? I refer to the letter a copy of which is filed as Exhibit 94 from Mr. Sims to Mr. Arthur Koontz. Did you see that letter or learn of it having been written about that time?

A. No, I don't recall seeing that letter.

[fol. 2770] Q. Was there a meeting of directors of the company shortly before Mr. Sims instituted his proceedings in the Circuit Court of Kanawha County, West Virginia, in April of this year?

A. Let me answer that in this way. I had a call from Mr. Koontz that matters were serious for Fidelity, and that he would like me to come to Charleston, and my ledger shows that I came here on the night train April 3, 1941, and on April 4, the following day, Mr. Risley and Mr. Latta and Mr. F. J. McNulty and I were in Mr. Koontz' office and we did spend several hours considering the possibilities and what could be done, with the attitude of Auditor Sims to invoke court proceedings.

Q. You did not attend a meeting of directors?

A. Yes, but that was the following week.

Q. The following week?

A. That was Monday, April 7th, and I think perhaps the meeting was recessed until April 8th.

Q. Well, what decision was reached with regard to those matters at those meetings?

A. Well, tersely stated, the situation could not be reme-

[fol. 2771] died; they felt that they could not conform to what the Auditor desired; and I believe a resolution was passed employing the firm of Koontz & Koontz to represent the association in prospective litigation.

Q. Were you contemplating that the company would be liquidated or reorganized—and when I say "you" I mean the board of directors.

A. Well, the discussion was that under the statute—I think it was 3325 of the 1937 Code—the Auditor would go into the Circuit Court of Kanawha County; and it was felt,

under the language of that section and the power of administering the assets, that he could have the reorganization there desired. The plans of reorganization were entirely nebulous, but they were all talking of reorganization.

Q. Nobody had any very definite, concrete idea about it?

A. None except Mr. Latta.

Q. Mr. Latta?

A. Yes.

The Court: What plan did Mr. Latta have?

A. Judge Moore, he did not set it down on paper. He [fol. 2772] had had experience in several reorganizations, and I remember a very healthy discussion in the library at Koontz & Koontz's office, but I couldn't repeat other than they had a plan of some equitable whittling from the contract holders.

Q. Well, did he have a plan which was discussed and which impressed his associates as being a possible and feasible plan?

A. Mr. Risley and Mr. Koontz and I were impressed with it, yes. I should say, answering fully, that Mr. McNulty was not.

Mr. Farmer:

Q. Was the question of a reorganization through the federal court—bankruptcy—was that considered or discussed at that time?

A. No, I don't recall, back in Wheeling on the 7th and 8th of April, that very much discussion was given along that line. I think the matter was rather determined here, for after spending several hours in discussion in the library of Koontz & Koontz Mr. Arthur Koontz and I went up to see Auditor Sims, and Mr. Justice was there at that time.

Q. And what message were you to convey to Auditor [fol. 2773] Sims?

A. Well, we told Mr. Sims that we were giving the matter serious consideration; and he assured us again that he was going to act, that he had referred the matter to the Attorney General; and I recall that he questioned what procedure we thought advisable, and I think it was Mr. Koontz who facetiously responded, "That is a peculiar thing to ask us to write our own prescription for our death knell."

I recall one thing—I don't know whether it was Auditor Sims brought the matter up or Mr. Justice; it rather impressed me and I think it impressed Mr. Koontz—that some years ago the National Surety Company had been in financial trouble, and the New York Insurance Commission had requested certain cooperation from the Insurance Commissioners of othter states, and as a matter of commity, courtesy, he got that, and Auditor Sims was very much pleased with the way that had worked out, and he said then he felt that the matter could be held under control, if it was decided upon, in the state court; it would be convenient for him and for the Attorney General to handle the [fol. 2774] matter, and that he intended to send telegrams to the insurance commissioners in the various states, and I think Mr. Justice said he had the telegram pretty well formulated that he expected to send out to the various states asking that they hold the reserves deposited and all matters for the action they expected to take care of it.

Q. Was Mr. John Marshall, Sr. in accord with the views of the rest of you gentlemen and Auditor Sims at that time?

A. I don't know how to answer that, Mr. Farmer. I don't remember—I don't remember any strenuous position.

Q. Did he make any objection to the proceedings in the state court on the ground that it ought to be in the federal court?

A. Not that I recall.

Q. Did anybody make insistence that the proceedings ought to take place in the federal court and not in the state court?

A. No, there seemed to be unanimity, as well as I recall. Four of us had been down here and had considered the matter, and told, as completely as we could, the various mat- [fol. 2775] ters that had been discussed. As I recall—another thing that I believe was done, either Monday or Tuesday, April 7th or 8th, a committee was appointed to consider plans for reorganization; and if I am not mistaken Mr. A. G. Messick was named chairman of that committee. Then along about five o'clock in the evening of April 8th, I understood that Mr. Robert J. Riley had been employed by that committee. Mr. Riley telephone me that he had been employed by the reorganization committee and wanted some advice about their work. I said, "Well, you

are moving too fast for me; I don't know just what you have in mind."

Q. Who is Mr. Riley?

A. He is an attorney of Wheeling, West Virginia—a very capable attorney.

Q. Who are the members of that reorganization committee besides Mr. Messick?

A. I never heard the personnel, but on Wednesday, April 9th, Mr. Riley told me that he was going to Charleston, going with Mr. Messick, Mr. Pulfer and Mr. John Marshall, Jr.; and then he talked to me that evening, the evening of April 9th. He was back in Wheeling and said [fols. 2776-2778] they had been out to see Mr. Partlow, Assistant Attorney General, and had gone over the bill of complaint and had made some suggestions.

Q. That bill of complaint was later filed in the state court?

A. The bill of complaint was filed in the Circuit Court of Kanawha County, West Virginia.

Q. Well, did the board of directors authorize Mr. Koontz or Mr. Koontz's firm to appear in that suit in that proceeding in the state court?

A. Yes, I stated that, and that action was never revoked as long as I was a member of the board.

* * * * * * *

[fol. 2779] Mr. Farmer:

Q. State whether or not it was the concensus of opinion of you gentlemen who were directors and officers and attorneys for the company, perhaps other than Mr. Fleming, that the only fair chance of a reorganization of the com-[fol. 2780] pany would be as an insurance company, with the voluntary concurrence of contract holders and the various state officials and depositories through proceedings in the state court—Kanawha Circuit Court.

A. Well, that is a pretty broad question. I wouldn't want to undertake that—to answer for all of them. I felt that so far as an investment company was concerned that we were done. I couldn't see any possibility to carry on in the investment field. We couldn't qualify and go ahead under the Investment Act of 1940, and I felt that that type of business had had its day. As an insurance company, if we could work into that, I felt that there was a possibility

of placating our people and having them comfortably go along.

Q. Well, was it, or not, the opinion of the directors, or officers and counsel for the company, until Mr. Fleming appeared on the scene, that the interests of all the parties in interest in the company and the contract holders especially were adequately and properly taken care of through the proceedings in the state court that Auditor Sims had instituted?

A. Yes, I think they all felt that the Circuit Court of [fols. 2781-2802] Kanawha County was adequate to carry through.

* * * * * * *

[fol. 2803] Q. Mr. Foulk, you have been familiar, particularly since 1938, to a great extent with the services Mr. Koontz rendered the company in a legal way, have you not?

A. I think so.

Q. And you were also familiar, to a general extent, with the fees paid therefor, were you not?

A. Yes.

Q. Isn't it true that there were servcies rendered for all fees paid and that the fees charged were reasonable for the services rendered?

A. Well, I will answer that in this way, Mr. Palmer, if I may. I never felt any of his fees were out of line with [fol. 2804] what I would have charged under similar circumstances if I had been able to furnish the service he did.

Q. It would have been substantially the same amount?

A. I never passed upon his fees except as a member of the board. It was thte duty of the general counsel to consider and to audit the legal bills and to pass thtem on to the board for approval and payment. I don't recall of any fee bills from Koontz & Koontz that were repulsive to me as being exorbitant.

Q. And you considered them reasonable?

A. All reasonable and fair, so far as I can recall. Do you have one in mind?

Q. None in particular, Mr. Foulk. Mr. Foulk, the cervices that were rendered by Mr. Koontz, were they necessary services to the company?

A. Absolutely.

* * * * * * *

[fol. 2805] Q. Now, Mr. Foulk, coming to the period of this year, the early part, it was determined in the latter part of 1940 that Fidelity could not go on as an investment or face amount securities company. Isn't that true?

A. Yes.

Q. And as you have stated, in your opinion, that type of business, I think as it has been expressed here before, was dead dodo. Is that correct?

A. Well, I don't know how it has been expressed here before.

Q. In your opinion that type of business was through entirely?

A. That is my personal opinion about it, Mr. Palmer. I felt disconsolate after I read and made some little study of the Investment Act of 1940. I have no adverse criticism to level. I just felt that we never could make the grade.

Q. It appeared to you that the Investment Companies Act of 1940, whether intentionally or otherwise, had legislated the type of business that Fdielity had been doing out of [fol. 2806-2819] existence. Is that correct?

A. It made it pretty difficult to follow.

Q. And, I say, your opinion was that it had actually or practically legislated that type of business out of existence as a practical matter?

A. Oh, I don't know that I want to characterize it that way, Mr. Palmer. If you mean the net result was that Fidelity could not continue under that rather precise and somewhat onerous legislation, yes, I felt Fidelity could not continue and could not live.

Q. So that Fidelity turned to the idea of a life insurance company as a means of continuing existence? Isn't that true?

A. That is true.

. . . . . .

[fol. 2820] Cross-examination.

By Mr. Lauritzen:

Q. Mr. Foulk, after you got the charter as an insurance company, do you know whether anyone from the company made an effort to contact insurance commissioners in the various states to determine whether you could get under way as an insurance company in those states?

(No answer.)

Q. Speaking of states other than West Virginia now.

A. Yes, Mr. McNulty and Mr. Risley had some contacts and Mr. Cattelle, of the Lincoln National Life—I believe he is an actuary—came to Wheeling, and then Mr. Messick brought to us a Mr. John Weaver, an attorney of Chicago, who at one time I think was president of the Postal Life, and he stated that Mr. Weaver would be an invaluable man in getting us qualified as an insurance company in the various states, as he was familiar along that line. Just how far Mr. Weaver went I don't know, because that was in January of 1941, and Auditor Sims' attitude was pretty pronounced from the middle of January on.

Q. Did you get a license or qualify as an insurance com-
[fol. 2821] pany in the State of Virginia?

A. No.

Q. Do you know whether any of the officials in Virginia were approached by anyone for Fidelity in that regard?

A. I do not, but I think not.

Q. Do you know whether the insurance officials of the State of Illinois were approached by anyone for Fidelity to see what the prospects of getting under way there as an insurance company were?

A. I think I was told that Mr. Weaver had made some overtures in Springfield, Illinois.

Q. Do you know what the result was?

A. I do not.

Q. Do you know of any other overtures that were made in states other than Illinois?

A. No, I do not.

Q. Do you know whether anyone connected with the company made any investigation to determine whether or not the company would be able to get under way as an insurance company in the various states?

A. I can only say, Mr. Lauritzen, that I understood Mr.
[fol. 2822] Messick had left that matter to Mr. Weaver.

Q. There was some mention here of Mr. Weaver having prepared a booklet of some kind, apparently a rate book or something of that sort. Do you have any information on that, Mr. Foulk?

A. Well, I think that is partially true. He brought to us a gentleman whose name I cannot recall, on the 31st of December, and that man made some compilation of figures and some submission. I don't think Mr. Weaver prepared a rate book exactly.

Q. This man Cattelle that you spoke of, will you tell us a little bit more about him?

A. You let your voice drop after Cattelle, I didn't hear the rest of it.

Q. Can you tell us a litle bit more about him as to who he was?

A. Well, he is the chief actuary of the Lincoln National Life, Fort Wayne, Indiana.

Q. Mr. Foulk, can you tell us when you first became acquainted with Mr. James R. Fleming, the counsel for the debtor in this proceeding?

A. I don't know the gentleman, Mr. Lauritzen. I was [fols. 2823-2825] here when this case opened in August. I happened to be in Huntington on a matter and I wanted to come over here and be here on the opening day, and I saw Mr. Fleming in the courtroom, but I was not introduced to him and I have never met him.

Q. Up until the time you resigned as a director of Fidelity on April 22, 1941, did you know whether or not Mr. James Fleming had any connection with Fidelity?

A. He had no connection—if I understand your question, he had no connection as long as I was associated with Fidelity.

Q. Had he done any work for it as long as you were associated with it?

A. Not to my knowledge. I think Mr. Messick made some mention of him at that time. The name Fleming meant nothing to me—on the meeting of April 7th or April 8th, but I can't go beyond that.

. . . . . .

[fol. 2826] Q. Then, of course, you were here in Charleston conferring with Mr. Koontz and others with reference to the affairs of Fidelity?

A. Yes, sir.

Q. And the financial difficulties in which Fidelity found itself?

A. Yes, sir.

Q. You were trying ot find a way out, is that right?

A. Yes, sir.

Q. And then it was the purpose of the meeting in Wheeling on the 7th to devise means of working Fidelity out of the situation in which it found itself?

A. Rather.

Q. And then you decided, did you not, from the time you first began to discuss it, that the only solution for it was [fol. 2827] to go into the state courts? Didn't I understand you to say that or in effect that?

A. Well, I suppose we are aiming at the same thing, Mr. Townsend. Of course, I don't want to quibble about it. Mr. Messick said he called the meeting of April 7th, notice for which was sent out about the 27th or 28th of March—he said he called the meeting because he felt it his duty as chairman of the board to acquaint the board with the fact of the financial—desperate financial situation that was existing. That meeting was called before I came down here to Charleston for that consultation at the instance of Mr. Koontz, and when you asked the other question as to the board of directors deciding what court to go into, why I remember that that was a matter of—not ridicule; it was a matter of some concern and some jesting, that we had no prerogative in the matter particularly; the Auditor had the right to choose his forum. We felt that the Auditor was considered in the matter.

Q. You thought that the Auditor had the exclusive right to suggest the forum for a reorganization of Fidelity.

[fol. 2828] A. We did not feel that he had a reason to lean on us to indicate a——

Q. Well, the Auditor suggested going into the Circuit Court of Kanawha County.

A. The Auditor was willing to go, as the board indicated.

Q. Well, the board indicated the Circuit Court of Kanawha County.

A. The board indicated it had no objection and would not contest the matter if it was filed.

Q. And nothing else was suggested except to go into the Circuit Court of Kanawha County?

A. I think there was some discussion as to whether that was preferable to the federal court.

Q. And it was decided that it was?

A. Yes.

Q. Do you think that way about it yourself?

A. Yes, I will have to say, in fairness to myself, Mr. Townsend, that I have never had a case in the federal court, so it was onesided knowledge on my part which I sent to the board.

Q. It was just about the unanimous consent of the board [fol. 2829] of directors and the parties who met from April

3rd down to April 8th, that the only place to reorganize Fidelity was in the Circuit Court of Kanawha County?

A. I think Mr. Messick offered the two possibilities that they might consider. I think he fairly presented the matter.

Q. Well, what was said with reference to going into the federal court? Were the advantages and disadvantages of it discussed at all?

A. They were not presented by me.

Q. Was Chapter 10 ever mentioned——

Mr. Palmer: Wait till Mr. Foulk finishes his answer.

The Witness: That is all right. I am trying to answer Mr. Townsend.

Mr. T. C. Townsend:

Q. Was Chapter 10 ever mentioned in the course of these suggestions?

A. I think Mr. Messick presented the matter, as I recall it, the two possibilities.

Q. The possibility of reorganizing under Chapter 10?

A. I think so, as I recall it.

Q. Is your recollection clear about that?

[fol. 2830] A. Pretty clear, Mr. Townsend.

Q. Did Mr. Koontz discuss it?

A. Mr. Koontz wasn't there.

Q. Well, you were down here in Charleston discussing it with Mr. Koontz.

A. All right, let's go slowly. We were talking about the director's meeting.

Q. I am asking you another question now.

A. Yes, Mr. Koontz——

Q. And you were talking here in Charleston with Mr. Koontz and the staff of Mr. Koontz's office with reference to reorganizing Fidelity, weren't you?

A. Yes.

Q. And you never discussed at all the possibilities of reorganization under Chapter 10 and in the federal court? Is that right?

A. No, that is not right.

Q. Did you discuss it?

A. Yes, sir.

Q. In the federal court?

A. You are talking about the Koontz office in Charleston?

[fol. 2831] A. I am talking about the Koontz office in Charleston.

Mr. Palmer: May I suggest that the court reporter can't possibly get that examination? I am only making that suggestion, so we can all hear it and get it.

Mr. T. C. Townsend: The reporter hasn't complained yet.

Q. Let me get it clear. While you were discussing this matter with Mr. Koontz and Mr. Koontz's staff, you discussed state courts and federal courts?

A. I didn't discuss the federal courts.

Q. Well, did anybody—

A. Will you let me tell you?

Q. How?

A. You want me to answer, don't you?

Q. Yes.

A. Well, give me a chance.

Q. Well, I thought you had it.

A. Did anyone? Yes. Mr. Goldsmith had had considerable experience, and mentioned several cases, and Mr. Koontz had had experience; but, Mr. Townsend, from the federal end I had had no experience, hadn't made a real [fol. 2832] study of the Chandler Act, and I wasn't able to contrast the cases.

Q. They did?

A. Yes.

Q. In your presence?

A. Yes.

Q. And what was their conclusion?

A. Their only one was that the state court was adequate to give the reorganization desired.

Q. Why?

A. I think it was a matter chiefly of expedition, for the Auditor to have the advantage of the Circuit Court of Kanawha County.

Q. Did they discuss it because it was advantageous for the Auditor or because it might be best for the contract holders?

A. They talked about the contract holders considerably and decided that both the Auditor and the contract holders would fare better in the state court.

Q. Did you not, at this meeting in April, when you discussed this matter with Mr. Koontz and considered the

question of reorganization, know you had to control all the [fol. 2833] assets of Fidelity before you could promote a plan of reorganization?

A. Yes.

Q. Was that discussed?

A. Yes.

Q. How did they propose to get the control under a state court receivership in Kanawha County?

A. Well, I think I stated that we hadn't thought that entirely through, but the Auditor suggested that the Insurance Commissioner of New York, in the National Surety case, had had a very co-operative working relationship and the assets had been conserved by the various insurance commissioners, and actions had been prevented.

Q. And because that was suggested, you thought that was the thing to do?

A. Oh, yes.

Q. And Mr. Koontz thought that was the thing to do?

A. I was impressed by what had been done in that instance.

Q. Then Mr. Koontz and the legal staff of Mr. Koontz's office thought that was the thing to do because Mr. Sims had [fol. 2834] suggested it. Is that right?

A. I don't know that anyone was present except Mr. Sims and Tom Foulk when the Auditor suggested that.

Q. You thought at that time the state court was preferable?

A. Yes.

Q. Do you think so now?

A. I do.

Q. And it can be reorganized better in the state court than it can in the federal?

A. I don't believe I can answer that. You say better?

Q. More successfully—I will put it that way.

A. Well, I still could not contrast the two. I think the state court is adequate, and I confess, as a states-righter I somewhat prefer the state courts.

Mr. T. C. Townsend: Now——

The Court: Wait, Mr. Townsend. He says, as a states-righter, he prefers the state court.

Mr. T. C. Townsend: May I ask him a question?

The Witness: Certainly.

Mr. T. C. Townsend:

[fol. 2835] Q. In this discussion in Mr. Koontz's office, did he tell you he had ever discussed any plan of reorganization with SEC?

A. I don't know that he did at that time, Mr. Townsend, but I think several weeks before that that he and Mr. Risley had been over with a Mr. Carver at the Securities and Exchange Commission in connection with the plan for reorganization.

Mr. Ray: Did Mr. Koontz tell you he had these discussions before the state court receivership was filed and that the Securities and Exchange Commission had advised him that it was the Commission's opinion that the reorganization should be in the federal court under Chapter 10?

Mr. Reinhardt: I object to that, your Honor.

Mr. Palmer: I object.

Mr. Reinhardt: There is no such evidence in the record.

Mr. Ray: I think there is a letter here that pretty clearly shows it.

The Court: I don't think that there is a letter that shows that anybody told Mr. Koontz that. You are talking about Mr. Marshall, I suppose.

[fol. 2836] Mr. Ray: I am talking about the letter from the member of the Commission in which it recites what he stated to Mr. Koontz about the way it should be reorganized.

The Court: I didn't remember that.

Mr. Ray: I may be wrong. May I look at the letter?

Mr. Palmer: The letter was read in evidence.

Mr. Ray: The part I am asking about is the part that was read.

Mr. Palmer: Let's have the whole letter. I would like to see the whole letter, as a matter of fact.

The Court: The Court is not going to let you see a private letter. This letter was put in here by reason of something that you brought out, Mr. Palmer, that the Court said was improper and should not have been mentioned, but it was mentioned and it got into the record, and now, if Mr. Ray can find any such allusion in the letter, I will be glad to know about it, so I can rule.

Mr. Palmer: For that reason, your Honor, I think your Honor's ruling is correct, that there is something in the

letter about which Mr. Ray has asked which has not been [fol. 2837] in evidence, and it would be only right that the counsel should see the rest of the letter to see what was said on that particular subject.

The Court: No question about that.

Mr. Palmer: That is what I had in mind.

Mr. Reinhardt: I was under the impression that Mr. Ray was referring to that part of the letter that had been read in evidence.

Mr. Ray: I am referring to it. If it is not in that part, of course I will withdraw the question.

Mr. Farmer: You had the whole letter, didn't you, Mr. Ray?

Mr. Ray: We will have to go back and check the record.

(There was a discussion off the record.)

The Court: Mr. Ray is right about that. The letter in question does state that the Commissioner who wrote the letter had a conference with Mr. Koontz relative to a proposed plan of reorganization, and that the Commission indicated at that conference that it would be unable to render a favorable report on any plan which did not comply substantially with the standards of Chapter 10 of the Bank- [fol. 2838] ruptcy Act.

Mr. Palmer: Your Honor, I believe that was a part of the letter that wasn't read before.

Mr. Reinhardt: This is a part that was read, but that is substantially different from what Mr. Ray said.

Mr. Palmer: And that occurred on May 9th, I am advised, and not prior to the receivership.

The Court: Read the question.

(The question was read.)

Mr. Ray: I will amend the question to say that any member or representative of the Commission had expressed an opinion that it should be.

The Court: The expression is, not that it should be in the federal court, but should conform to Chapter 10 of the Bankruptcy Act.

Mr. Ray: I will amend the question in that way.

Mr. Palmer: Your Honor, this letter was *April* 9th, after the state receivership proceedings, and it does not say when the conference with Mr. Koontz was held. This question

asks if it didn't say something before the state receivership was brought.

Mr. Ray: Mr. Foulk testified when Mr. Koontz was before [fol. 2839] the Commission.

The Court: Since this part of the letter is in evidence, that there was a conference and that such a statement was made to Mr. Koontz, I think this witness may be asked whether or not that was discussed in his conversation with Mr. Koontz.

A. I think Mr. Koontz told me on the 4th of April that he felt the Securities and Exchange Commission favored the federal court.

Mr. Ray: Did he state that at the directors' meeting on April 7th?

A. I have said three times, Mr. Ray, that he was not at the directors' meeting.

Mr. Palmer: Nor was he a director at that time.

Mr. Ray:

Q. Did you advise the directors of that opinion of the Securities and Exchange Commission?

Mr. Reinhardt: That was an opinion of Mr. Koontz, your Honor.

The Court: Well, I understand that.

The Witness: Now, wait a minute. I don't know what the question was.

(The question was read.)

[fol. 2840] A. No, I didn't advise them of any opinion from the Securities and Exchange Commission.

The Court: Well, did you advise them that Mr. Koontz had made that statement to you, that he felt that the Securities and Exchange Commission favored reorganization in the federal court rather than state court?

A. I don't know. I don't know whether that statement was made on April 7th or not.

* * * * * * *

[fol. 2841] The Court: We might save time by reading into the record again this part that does concern the matter. It is in there once, but it may as well go in now. I believe perhaps that two paragraphs of the letter ought to

be in the record to make the matter complete and I will read them in. This is from the letter to Mr. John Marshall signed by Robert E. Healy, Commissioner of the Securities and Exchange Commission, dated May 9th, 1941.

"I believe your informant is in some confusion as to what has actually occurred. Mr. Jaegerman and other members of the Commission's staff have been constantly in touch with representatives of Fidelity, including Mr. Koontz. A few weeks ago a proposed plan of voluntary [fol. 2842] reorganization was submitted to the Commission informally by Mr. Koontz. He requested an informal expression of the Commission's views. The plan was carefully considered by the Commission. Upon such consideration the Commission indicated that the plan was of such a character that it was very doubtful whether the Commission would be able to render a favorable report thereon under the Investment Companies Act of 1940. The Commission further indicated that it would be unable to render a favorable report on any plan which did not comply substantially with the standards of Chapter 10 of the Bankruptcy Act in relation with corporation reorganization, and further that in its judgment it was very doubtful that a plan of reorganization could practicably be effected without resort to the reorganization procedure of Chapter 10.

"In view of the series of consultations which have taken place between representatives of the Commission and representatives of Fidelity, and of Mr. Koontz's request, the Commission considered it fair that Fidelity be advised of the Commission's tentative views. Mr. Koontz was so advised. It was my understanding that Fidelity did not [fols. 2843-2845] concur in the Commission's idea that a reorganization could most successfully be effected under Chapter 10, and that instead a voluntary reorganization in the West Virginia state court is being attempted."

* * * * * * *

[fols. 2846-2850] Mr. Gray: If the Court please, may I make a motion before we adjourn? I will be very brief, your Honor. It is a motion to dismiss and vacate the order, and pursuant and in support of the answer and petition filed in this cause by Edward J. Hughes, Secretary of State of Illinois, and by the Treasurer of the State and the Receiver. I am offering this motion at this time, your

Honor, because of the local character of the evidence going in now, and in view of the statement of the Court that there was no demarcation between the close of the petitioner's evidence and the defendants'. I would like to have this considered at the close of all the evidence, and in case the petitioner produces further evidence, but I understand they are through and it is because I will not be able to be here Monday or Tuesday of next week.

* * * * * * *

[fol. 2851] Mr. Gray: If your Honor please, I am asking leave to file this motion, and by the way, my train leaves at 9:50, and I will make a brief statement about the order which I am suggesting to the Court in connection with it, which is for the purpose of the pendency of your Honor's and such other courts as may be interested in the deliberation upon the reorganization processes; but I don't understand, in asking the Court to make this order clarifying the former order, that it is binding upon the Court in the event that proceedings to reorganize should fall down. In that event, I will consider the question anew to reinstate our objections and such suggestions in the proceedings as may be found necessary, and consider that the Court will enter such orders in that behalf by way of proper servicing of assets in the meantime. I have submitted to Mr. Reinhardt an order following our alternative prayer in the intervening petition which [fol. 2852] in substance permits the assets to remain up there until such time as they are needed in reorganization, or in the event that some new occasion would arise which might make it necessary for the proper administration of these proceedings by the Court.

Illinois has always taken the position that to have reorganization the Court in which reorganization is had must have authority to carry it out and must also recognize the pledges which may be impressed upon the property. We still take that position, and therefore, in that connection, I am tendering to the Court my views of an order which would relieve Illinois from the immediate attention of the Court in these proceedings, and I believe will not injure either party to the litigation. If your Honor will examine it later, whether you desire to enter the order or not, I will be very happy either way the Court disposes of it.

The Court: The Court has already seen the order that Judge Gray speaks about, and I am of opinion that the matters in the order are of no concern to any of the parties in

litigation other than the representatives of the State of Illinois and perhaps the Trustee. The order satisfactorily [fol. 2853-2854] clarifies the former order of the Court, with this understanding, which I wish to put on the record, that in entering this order the Court wishes to make it clear that in the event the jurisdiction of this Court is sustained in this proceeding, the Trustee of the Debtor is to have the management of the securities in the hands of the State of Illinois, with the right to sell and substitute, and also that in the final event no reorganization is had and the company is liquidated, the Court reserves the right at that time, subject to any objections of the State of Illinois, to require the funds to be liquidated through the Trustee.

Mr. Gray: The State of Illinois has reserved the right to object to that eventuality if the occasion arises in the future, your Honor.

* * * * * * *

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[fol. 2855] JOHN MARSHALL, SR., recalled, testified as follows:

Direct examination.

By Mr. Ray:

* * * * * * *

Q. Did you attend a meeting of the stockholders of Fidelity Assurance Association held at Wheeling on October 3, 1941?

A. I did.

Q. Do you have the minutes of that meeting with you?

A. Yes, sir.

Q. Is the call for that meeting attached to the minutes?

A. Yes, sir.

Q. How was the meeting called?

A. It was called by having more than 1/10th of the stockholders—I think by sixteen stockholders owning more than 1/10th of the stock of the company.

Q. That call was in writing?

[fol. 2856] A. Yes, sir.

Q. What notice of the meeting was given?

A. A written notice to all the stockholders and certificate holders.

Q. Is a copy of the notice attached to the minutes of the meeting?

A. I think so. Yes.

Q. Is an affidavit that a copy of the notice was mailed to all of the stockholders and certificate holders more than ten days prior to the meeting attached to the minutes?

A. That is correct.

Q. Do you know whether any other publicity with respect to this meeting was given?

A. There was quite an extended account in the morning newspaper, and I understood that it was also broadcast on the radio, although I did not hear it.

Q. Please state whether or not a directors' meeting was held immediately after the stockholders' meeting?

A. That is correct.

Q. Do you have the minutes of the directors' meeting with you?

[fol. 2857] A. I do.

Mr. Ray: We now offer in evidence as Debtor's Exhibits ——

Mr. Palmer: Objection, your Honor.

The Court: Overruled.

Mr. Ray: (Continuing:) The minutes of the stockholders' meeting held on October 3rd and the minutes of the directors' meeting held on October 3rd.

Exhibits 98 and 99

The minutes of the stockholders' meeting were admitted in evidence, marked Exhibit 98, and the minutes of the directors' meeting were admitted in evidence, marked Exhibit 99, and the same are attached hereto as a part hereof.

Mr. Ray: The minutes of the stockholders' meeting, introduced as Exhibit 98, are found on pages 182 to 185, inclusive, of the minute book, and the minutes of the directors' meeting, introduced as Exhibit No. 99, are found on pages 186 to 189, inclusive, of the minute book.

Q. Mr. Marshall, will you state, so far as you can remember, what stockholders and certificate holders were present at the meeting in person?

[fol. 2858] A. Well, the stockholders' meeting was held in the sales organization room, the largest assembly room in

the building. The room was filled; I should say there were 40 or 50 people there, including some of the most prominent business men in Wheeling, and so far as I can ascertain practically all of the large stockholding interests were represented, Mr. Bachmann, Mr. Charles H. Copp, I think owns about 600 shares, an officer of the Dollar Savings; Mr. H. C. Hazelett, Mr. D. A. Burt, and quite a number of persons in the room I didn't know, but I should say it was as largely attended a stockholders' meeting as I have ever seen in Fidelity.

Q. Please state whether or not a resolution was presented to the stockholders' meeting ratifying, approving and confirming the action of the officers and directors of the company in instituting this proceeding for corporate reorganization of the company in the U. S. District Court for the Southern District of West Virginia?

Mr. Palmer: Objection.

The Court: Don't the minutes show that?

[fol. 2859] Mr. Ray: They do. The resolution is in the minutes.

The Court: That would be the best evidence of it.

Mr. Ray: I didn't ask him what it was; I just asked him if it was introduced.

The Court: Well, the minutes show that, don't they?

Mr. Ray:

Q. Mr. Marshall, will you refer to the minutes and read such portions thereof as represent any action taken at the meeting in respect to this corporate reorganization proceeding?

The Court: I don't think it is necessary for the reporter to take down what he reads from the book, because it is already in evidence.

Mr. Palmer: Wouldn't it be easier, your Honor, to read all the minutes, so we would be advised of them without having to reread them?

The Court: Yes, just let the reporter show that the witness read the entire minutes of both meetings.

(Thereupon the witness read the minutes.)

Mr. Palmer:

Q. Mr. Marshall, was that all the corporate action that had been taken?

A. If I understand your question correctly, the action taken by the stockholders and directors was reduced to the [fols. 2860-2865] form of minutes, and that is all the action.

Q. That is complete? No other action was taken?

A. No.

Mr. Palmer: Now, if your Honor please, we regret to have to challenge the right of Mr. John Ray to appear for the debtor. There is no authorization of any kind in any of these purported meetings of Mr. John Ray to appear for the debtor.

The Court: Overruled.

Mr. Ray: You must not want me?

Mr. Palmer: No, Mr. Ray, I assure you it is nothing personal; I want the Court to appreciate that; but I find nothing in the corporate minutes of any kind or in the stockholders' meetings authorizing Mr. Ray to appear for the debtor in these proceedings.

. . . . . .

[fol. 2866] Mr. Palmer:

Q. Mr. Marshall, can you tell us how many shares of stock were deposited with you as trustee, both common and preferred?

A. I think the percentage was around 51 per cent, I think, of common, and I wouldn't be certain about the preferred. I think it was 54, perhaps.

Mr. Ray: Your Honor, if Mr. Palmer wants the record correct about that, the stock was deposited with a depository and the exact number of shares is shown in the tellers' report in the minutes.

Mr. Palmer: Show me that.

Mr. Ray: Right there at the end of the minutes.

Mr. Palmer: Which meeting?

Mr. Ray: The last meeting. The tellers' report is filed with the minutes of the meeting, I think. (Indicating.)

[fol. 2867] Mr. Palmer: This shows that at the meeting on October 3rd the number of shares of preferred stock deposited with the trustee was 4,769, undeposited, represented in person, 88; undeposited, represented by proxy, 54. Common stock, number of shares deposited with trustee, 4,801; undeposited, represented in person, 75; undeposited, represented by proxy, 100.

Q. Now, Mr. Marshall, getting back to your own shares, you said that you had 550 of common and 275 preferred. The 275 preferred was the result of a 50 per cent stock dividend? Is that correct?

A. That is correct.

Q. Of the 550 shares of common stock, how many of those shares did you buy?

A. Too many.

Q. Give us the number.

A. I can't do that, Mr. Palmer. I have been accumulating this stock—the first stock I bought must have been twenty years ago, from H. C. Ogden.

Q. How many shares was that?

A. I think it was 10 shares.

[fol. 2868] Q. Do you recall the price you paid for it, Mr. Marshall?

A. I think—my recollection is $150 a share. I may be wrong about that. It has been a long time ago.

Q. Can you tell us other purchases you have made, to the best of your recollection?

A. Well, I remember I bought Colonel March's stock when the Federal Trade Commission was given supervision over security transactions. He had been a member of the board and a member of the investment committee, and I had gotten him interested in Fidelity, and he asked me to buy his stock.

Q. How many shares is that, Mr. Marshall?

A. I think he had—my best recollection is 50.

Q. Tell us some other stock purchases.

A. I think I paid $155 for his stock.

Mr. Ray: Your Honor, I don't know the relevancy.

Mr. Palmer: I think it is to show the financial interest Mr. Marshall has in the company.

Mr. Ray: Is there any question about that? Who has—denied that?

The Court: I overrule the objection.

[fols. 2869-2871] A. I think when Mr. Scandrett retired I bought some of his stock.

Mr. Palmer:

Q. About how many shares, Mr. Marshall?

A. I don't remember. Most of these purchases of stock, with the exception of my initial purchase, was from directors or persons with the company who for one reason or

another were ceasing their activities, and persons particularly that I had gotten interested, when they would ask me I would take their stock. I never responded to any advertisements or circulars offering stock for sale. I never have sold any.

Q. The shares that you bought, then, were necessarily in small amounts?

A. Well, when you buy 50 shares of stock and pay $155 for it, that is not such a——

Q. I said, with the exception of those you mention, the rest were in small amounts?

A. No, I just can't remember. I have an indefinite recollection I bought some of Mr. Good's stock when he died. But I finally accumulated 750 shares, and I gave each of my boys a hundred which left me 550 of common stock.

[fol. 2872] Q. Mr. Marshall, when did you first start to take an active interest in the policies of the company?

[fol. 2873] A. I used to talk a great deal to Mr. Paull during his lifetime about it, but I never came on the board until after his death.

Q. All right, then; it was after his death that you began to take an active interest in the policies of the company. Is that correct?

A. Yes.

Q. Could you refresh my recollection as to the year of his death?

The Witness: Was it '22, Philip?

A Voice: About 1920.

Mr. Palmer: Mr. Marshall, isn't it true that in the 1920's, Fidelity sold a large number of securities from its portfolio with the expectation that the securities market would go down and they would be able not only to purchase those back but to purchase a larger amount of securities back?

A. When was that?

Q. In the 1920's.

A. I never heard of that, Mr. Palmer.

Q. When was Mr. Scandrett connected with the company?

A. I should say in the twenties, but what time I am not [fol. 2874] sure.

Q. Mr. Marshall, on the special annuity contract was there a reserve set up by Fidelity in accordance with the contract?

A. I assume so.

Q. Where did that reserve go?

A. What do you mean, where did it go?

Q. Just what I said, where did it go?

A. I don't know what you mean, Mr. Palmer.

Q. It is not there at present. Where did the securities go?

A. I don't know. I don't know what you are talking about. I am sincere; I don't understand you.

Q. You said that there was a reserve set up.

A. I did not.

Q. Beg your pardon. You said——

A. I assume so.

Q. You assumed so. You were actively interested in the company?

A. I am.

Q. And you were?

A. I was.

[fol. 2875] Q. Then you know that there was a reserve set up, don't you?

A. I am not going to discuss the technical features of the accounting method, because I don't know anything about it.

Q. As a substantial stockholder, why didn't you know where the reserves went or whether they were set up?

(No answer.)

Q. Answer my question, please.

A. I don't know what you are talking about. What do you mean? Where could reserves go?

Q. That is what I want to know.

A. I don't understand you. You mean where did the securities go that were——?

Q. Yes, sir, where did the securities go?

A. Well, they had an investment committee, a mechanism of handling the security transactions, and as far as I know there has never been any change with respect to that.

Q. Well, the present reports show that if the special annuity fund pays back its note to the other funds it would [fol. 2876] not have a nickel in it. Where did that money of the securities go, Mr. Marshall?

A. You will have to ask someone that is more familiar with it than I.

Q. I am asking the principal stockholder in the company and the man who took an interest in it. Where did it go, Mr. Marshall?

A. I have been here in the courtroom a good many days, Mr. Palmer. You could have asked all those questions from witnesses that were competent to testify. I don't understand what you mean, where did it go? You are not intimating that there was anything wrong about any of those transactions?

Q. I am asking questions only, Mr. Marshall, and making no intimations.

A. Well, I just don't understand what you are driving at.

Q. All right. In the special annuity fund at the present time the reserve set up for it, if it would pay back what it owes on its note to the other funds, there wouldn't be a nickel in that fund. Why?

A. Well, I don't know that that is true, in the first place, [fol. 2877] and I don't feel competent to answer it.

Q. Assume that it has been given in evidence by Mr. Isaiah Smith, an employee of the trustee, and accept it on that assumption, Mr. Marshall, why isn't there any money or securities in that fund?

A. I am not going to assume anything that I don't know anything about.

Q. Why didn't you know about it, as the principal stockholder and the man actively interested in the company?

A. Know about what, Mr. Palmer?

Q. About why there isn't any money in this special annuity fund?

A. I don't know that there isn't.

Q. I am asking you to take the figures of Mr. Isaiah Smith, an employee of the trustee, and if you don't know that there wasn't any money in it, why don't you know it?

The Court: Well now, Mr. Palmer, I think this witness has answered you——

Mr. Palmer: I think your Honor is right.

Mr. Jaegerman: Your Honor, for the purpose of the [fol. 2878] record, Mr. Smith never testified that about the annuity fund.

Mr. Ray: And, your Honor, if Mr. Palmer had wanted to find out where the securities and money went, he has had bookkeepers and accountants and statisticians on here day

after day who were familiar with the books and records, and these transactions were all on the books and records, and he should have asked those witnesses, if he wanted to know, where those securities went.

The Court: If you have any evidence, Mr. Palmer, that this witness took any of those securities wrongfully, then the Court wants you to put that in, and not convey that impression by innuendo by asking questions about it.

Mr. Palmer: If your Honor please, I don't think my questions carried that innuendo. I certainly did not so intend. I simply wanted to know why the principal stockholder of the company doesn't know where the funds set up for contract holders went to, and I think that is a proper question.

The Court: You were asking questions at the top of your voice with the evident purpose of in some way making some [fol. 2879] implication of wrongful conduct on the part of the witness. The Court doesn't want the record made in that way. If you have any proof of wrongful conduct, I am glad to receive it, but I don't want you to get that into the record simply by asking questions about it unless you have something to back those questions up. That was done in connection with the letter Mr. Marshall wrote, and the Court said at that time, and reiterates, that that was an improper thing to do in this case. I want you to govern your questions according to the statements I have just made.

Mr. Palmer: If your Honor please, I believe my questions have been directed at the knowledge of this witness. That is what I want to discover, his knowledge or lack of knowledge.

The Court: He has answered you a number of times and there is no use to pursue that any further.

Mr. Palmer: Now, Mr. Marshall, with reference to the special income fund, would your answers be the same concerning the reserves of it as they have been to my other questions?

A. Mr. Palmer, I am not going to attempt to explain [fol. 2880] situations with respect to particular reserves back of different contracts, because I am not competent to do it. I was active in Fidelity along many lines, but certainly not as far as accounting was concerned.

Q. You were, of course, the principal stockholder and as such directly interested in it.

A. I was active; I served on the investment committee; I served on the discount committee; I served on the executive committee and I served with the board of dierctors; and each day I was furnished with what they call the green sheet showing the individual sales of every salesman; I went over to the country to address all sorts of meetings of Fidelity; I certainly was active.

Q. Did you ever investigate as to whether or not the reserves required by the special income and special annuity policies were actually being set up?

A. I never specially investigated it, no.

Q. Did you know whether they were being set up or not?

A. All I would know is what the reports of the officers we have in charge would make, and I think I understood the [fol. 2881] situation as it went along from time to time as well as an ordinary director does, but——

Mr. Palmer: Will you read my question, Mr. Price?

(The question was read.)

Q. I am not certain that you answered my question directly.

A. What was being set up, Mr. Palmer?

Q. Reserves in special income and special annuity funds.

A. I am not going to try to particularize on certain contract funds, because I am not competent to do it.

Q. My question is to your knowledge, did you know whether or not they were being set up?

A. I assume, of course, that the reserves were being maintained for the maturity of the contracts.

Mr. Palmer: If your Honor please, I don't want to violate the Court's ruling, but I do think my question is a fair one and could receive a direct answer.

The Court: The original answer of the witness was that he knew as much about that as the ordinary director did, or as any of the others did, or something to that effect.

[fol. 2882] Mr. Palmer: I want to know his own personal knowledge whether he did know, and I ask the Court's permission to ask the witness to answer directly, yes or no.

Mr. Ray: May it please your Honor, I submit that when the witness said he saw the reports of the officers of the company, that that showed what his knowledge was.

The Court: Well, he ought to give direct answer and then such explanation as he cares to make, so, Mr. Marshall, the Court will require you to answer the question and then give such explanation as you have.

The Witness: May I have the question?

(The question was read.)

A. I think as long as I was active—I mean, when I first became active, and subsequently, we had regular—not only annual audits but often reports monthly. I read those reports, studied them and discussed them, and was informed from time to time about our situations.

The Court: Did you know whether or not these reserves were being set up? That is the question.

A. I knew they were being set up, your Honor. I also knew that there had come deficiencies in them, and I knew [fol. 2883] that we took action to try to improve the situation.

Mr. Palmer:

Q. Now, Mr. Marshall, when did you first learn there were deficiencies in those two series of funds I spoke about?

A. I can't remember that; whenever it became apparent, because we were getting reports constantly about the affairs of the association.

Q. It was back in the 1920's when that became apparent from the reports.

A. You mean around 1929?

Q. Before 1930 you knew from the reports that you saw of the company's officers that these special annuity and special income series funds or reserves had deficiencies in them?

A. I knew that that was the time when our whole portfolio suffered very heavily from market quotation losses.

Q. Isn't this further true, Mr. Marshall, that when certain series of contracts became due in the early part of 1930 or thereabouts the company did not have the money to pay them, so they pursuaded those persons whose contracts were coming due to take preferred stock in Fidelity [fol. 2884] in exchange for their maturing contracts?

A. I know that there was a stock unit—I think it had both common and preferred—authorized to be sold, and I

think, as a matter of fact, some contract holders made exchanges.

Q. Did you know that of the 5500 sold, nearly 5100 were from contract holders?

A. I didn't know what the figures were.

Q. You knew it was approximately that ratio, though, didn't you?

A. I knew that there was quite a number of contract holders exchanged their contracts for stock.

Q. You further knew that National Sales Agency at that time, the agency of Fidelity to sell contracts, was selling these stocks and at a commission?

A. That is right.

Q. And you knew that they were given a list of the contract holders as prospective sales?

A. I don't know who would give it to them. They had it themselves.

Q. They had it themselves. What was the contract made between Fidelity and National Sales as to selling the shares [fol. 2885] of preferred stock, or unit of preferred and common?

A. I cannot recall the details of it.

Q. Where would it be, Mr. Marshall?

A. I don't know.

Q. Would it be in the minutes of the board of directors?

A. That has been a great many years ago. I don't know.

Q. Where is the original sales contract between National Sales and Fidelity, Mr. Marshall?

A. I don't know.

Q. Have you ever seen it?

A. I don't know that I ever have.

Q. Was the contract made when you were actively interested in Fidelity?

A. I think that National Sales had a contract with Fidelity before I became interested in Fidelity.

Q. You think it was before 1920?

A. I think it was renewed from time to time.

Q. Beg pardon?

A. I think it was renewed from time to time after I be- [fol. 2886] came interested.

Q. You took part in the renewal of it?

A. That is right. There was quite a difference of opinion

among the directors as to whether we should sell the National Sales or whether we should contract to have our sales made.

Q. You were on the board of directors that approved the advances made to National Sales, were you not?

A. Yes, sir.

Q. You were on the board of directors when National Sales practically went out of existence owing the company a million dollars? Isn't that true?

A. That is right. I want to say, however, Mr. Palmer, that every advance that was made to National Sales Agency was recommended by the officers, and as I recall always supported by Fackler & Briby's certification that they had so much deferred commissions coming to them and that by experience the company would get that back.

Q. Mr. Marshall, as the principal stockholder and personally interested financially, therefore, didn't you investigate any of those situations?

[fol. 2887] A. I am just telling you I think we investigated very thoroughly when we had an actuary go over the figures and certify that we were exercising good judgment to advance up to a certain percentage that was due them. You understand they had deferred commissions coming to them if the contract holders kept up their payments.

Q. Didn't your experience with the company over a period of ten years show that the contract holders did not keep up their payments?

A. I am just saying Messrs. Fackler & Briby made that very calculation based on the experience of the company, but we ran into a very unusual period.

Q. The unusual period being from '30 to '35?

A. I should say it began about '29.

Q. And the unusual period lasted so long that you advanced them a million dollars?

A. But during this critical period was when the advances were made.

Q. Well, it ended up with your holding the sack for a million dollars? Isn't that true?

A. That is true.

[fol. 2888] Q. And you never cut it off before that time, did you?

A. Well, I think Senator Sutherland was president when the practice was finally stopped. I think he tired—he tried to be as careful as he could about it.

Q. And the practice was finally stopped by Auditor Sims coming with another gentleman to Fidelity and saying, "Either you will cancel your agreement with National Sales today or I will close you up."? Is that true?

A. I wasn't—you understand I never have been in Wheeling. I have been an officer of the company in the sense——

Q. Did you know of that happening, Mr. Marshall?

A. I knew that Mr. Sims objected to the practice.

Q. You saw, did you not, the letters Mr. Sims wrote to the company in which he said he wanted all the officers fired and he wanted officers put in who knew stealing when they saw it and were opposed to it?

A. I think there was some such letter, and I think we complied with Mr. Sims' desire by having Senator Sutherland resign.

[fol. 2889] Q. I think that is correct. And until Auditor Sims of the State of West Virginia stepped in, you, as an attorney and as principal stockholder, had not stopped this drain on Fidelity through National Sales? Isn't that true?

A. I was a director, and I am not going to dodge any responsibility, Mr. Palmer. I am simply saying to you, however, that these things were done by the officers. I say, if I recall, the officers asked authorization to advance certain sums, and that is the way it was done; and it wasn't that we wanted to do it, I can assure you; it was considered good business judgment to do it.

Q. The officers you had a large part in being able to select by virtue of being the largest stockholder, did you not?

A. Well, I don't recall ever having any division in Fidelity about who should be selected officers. I think all our meetings were just about like it was yesterday. The only thing I can say is I had a great deal to do with getting members to come on our board.

Q. I said that you had the power, Mr. Marshall, by virtue [fol. 2890] of being the largest stockholder, and your family having several times as much as anyone else, to elect the officers.

A. No, I did not have the power to elect the officers. If there had been a division in Fidelity, which there wasn't, and there is not now, I could have only elected a minority of directors. The directors elect the officers. I have never been in position to compel people of Fidelity to do what I wanted them to do.

Q. But you were in position to exercise very strong persuasion, were you not, Mr. Marshall?

A. I was a very large stockholder, comparatively, yes.

Q. And as such could and did vote it?

A. Well, I think we might have to spend a good deal of time to talk about influence. For example, while I felt that Mr. Sims made a great many splendid contributions to this company and his ideas of economy were in accordance with mine, I would not have asked Senator Sutherland to resign.

Q. You had helped pick Senator Sutherland, hadn't you?

[fol. 2891] A. I had.

Q. You helped pick Mr. Pole?

A. I did.

Q. You helped pick Colonel Thompson?

A. I was a director and voted for all those presidents.

Q. No, you just personally picked them and selected them and helped get them to be president? Isn't that right?

A. I was very active.

Q. Well, didn't you personally help do it?

A. Certainly; I was on the board of directors and helped do it, yes.

Q. Now, you personally——

A. I don't see how you want—how you separate me——

The Court: Mr. Palmer, I am not sure that I correctly get the purpose of your questions to this witness about his connection with the Fidelity company. If your questions are for the purpose of showing mismanagement on the part of the officers and directors of the company, I want to call your attention again to something that the Court [fol. 2892] has already expressed several times, I think, on the record, or if not on the record, at least openly, that it is not my intention at any times in the course of this proceeding to entrust any of the affairs of any reorganized company to any person who had anything to do with the condition in which this company had become involved. If any contrary impression was derived from the action of the Court in authorizing the stockholders' meeting, then I want to correct that, and say that the only purpose of the Court in authorizing that stockholders' meeting of yesterday was that the stockholders and directors might, if they legally could, correct any defects in the proceeding of June 3rd, and as to any control of the affairs of the company in this court, I repeat that they will not be

entrusted at any time to any of those persons. I don't know whether that was the purpose of your question or not.

Mr. Palmer: It was not the exact purpose, your Honor. Your Honor said that, and I had that in mind, so in order to find out who it is the Court should not entrust it to, I want to develop the facts from the man who knows it. I don't know whether the Court has in mind that Mr. Marshall is one of those persons that mismanaged it, or [fols. 2893-2904)] whether the Court has in mind it was mismanaged, but I do think the facts should be developed from which the Court should form his opinion as just expressed.

The Court: I am glad to have the facts developed. Whether they are pertinent in this hearing is doubtful, but I am going to let you go ahead.

. . . . . .

[fol. 2905] Mr. Palmer:

Q. Mr. Marshall, when was it that you first knew of a deficit in the general fund of Fidelity?

A. I don't know that I ever knew there was a deficit in the general fund except as it was a guarantee for deficiencies in reserve accounts.

Q. Well, when did you first know that there were deficiencies in reserve accounts other than the special annuity and special income?

A. I can't say the time, but I am certain I knew it as soon as it developed.

[fol. 2906] Q. You have heard a large part of the testimony here, and of course that has refreshed your memory. Can you tell us when that did develop?

A. No, I cannot.

Q. Did it develop as early as 1932?

A. I should think so.

Q. Did it develop as early as 1930?

A. I am not certain, Mr. Palmer.

Q. Then it is fair to state, Mr. Marshall, that from at least 1932, whatever the reason for it, Fidelity was in financial difficulties?

A. There was a depreciation on the market value of our securities. We, of course, had the alternative then to sell those securities and undertake to pay off the contract holders, and at market price we probably could have done it

at a certain time. We did hope, however, that the security market would come back, that we would be able to make earnings and supplement these reserves, and that is precisely what happened.

Mr. Palmer: Will you read the witness my question?

(The question was read.)

A. There were difficulties in that respect.

[fol. 2907] Q. Mr. Marshall, when you said you could have paid the contract holders off, but chose to go on, were you influenced in that by reason of the fact that you were the largest stockholder and had the most to lose?

A. No, I said that I didn't think at market prices we could have paid the contract holders off, and it is difficult for me, of course, to analyze my own motives, but I will say it was the judgment of all the officers and directors that we do just as we have done.

Q. I would rather you would confine your testimony, Mr. Marshall, if you will, please, unless I ask for it otherwise, to your own personal knowledge and your own personal actions, and my questions will be directed along that line, unless——

A. I understood you to ask me what my motives were.

Q. Yes.

Mr. Huwe: Your Honor, I think the witness has the right to qualify his answer any time it is necessary.

The Court: Go ahead.

Mr. Palmer:

Q. Mr. Marshall, you were on the payroll of Fidelity at least from 1931 on, were you not?

A. I can't remember the exact years.

[fol. 2908] Q. The report made by Mr. Gribben, which was introduced in evidence upon my request that he get all attorneys' fees back for ten years from the books of the company, showed that from—that during that entire period you were on the payroll of the company. That is true, is it not?

A. If that is what the book shows. I would not be sure.

Q. How many years before that were you on the payroll of the company?

A. I am saying I can't remember. I don't think before that——

Q. Beg pardon?

A. I don't think I was before that, but I may have been. Of course, you are also—I don't know whether purposely or not—confusing the firm of Marshall & Forrer with me personally. That is a partnership, and I am not the sole partner.

Q. I think I am not. The breakdown as given by Mr. Gribben shows that beginning January 1, 1931, John Marshall was on the payroll and the firm of Marshall & Forrer is given in a separate account.

[fol. 2909] A. In what capacity was I on the payroll in 1931?

Q. I am afraid you will have to answer that, Mr. Marshall. I don't know. You tell me.

A. I don't know that I was. I say when I became chairman of the board I was given a salary, just as the preceding chairman of the board was given one. When that happened, then is when I went on the payroll.

Q. Mr. Marshall, the books of the company, as put in by Mr. Gribben, show that you were drawing $83.33 a month beginning in 1931. Do you deny having received that?

A. No, I don't deny having received it. I said whatever the books show is, of course, correct.

Q. For what services were you being so paid?

A. I think if that is the service—it was a retainer, just as your firm was getting paid in Charleston, except they were getting $200 a month.

Q. My question, Mr. Marshall, is to you——

A. And I have answered plainly and definitely that it was a retainer—a legal retainer—and that is the amount of it.

Q. In addition to that retaining fee you, of course, re-
[fol. 2910] ceived your necessary travelling and other expenses which you incurred in behalf of Fidelity?

A. Correct.

Q. Mr. Risley has testified that within the last ten years you also received a part of your office rent paid by Fidelity. Is that correct?

A. That is correct.

Q. How much?

A. Well, I think it was something under a hundred dollars. Of course, my office was used, you understand, by the investment committee for their meetings as well as my acting as chairman of the board.

Q. How much under a hundred dollars?

A. I can't remember. Do your books show there?

Q. That is not shown on this report. That is why I am asking you.

A. Well, I say it was under a hundred dollars, and I can't remember the exact amount.

Q. Why wasn't it shown on the books as a legal fee to you, as all the other legal fees were shown paid every other lawyer.

A. I do not consider that was a legal fee. I have just [fol. 2911] explained that my office was used not only as the office of the chairman of the board but as a place of meeting of the finance committee.

Q. What part of your telephone bills were paid by Fidelity?

A. Only such part as were long distance calls on Fidelity business.

Q. What part of your secretary or stenographer's fee was paid by Fidelity?

A. Well, at one time it apportioned—I would say not over $50.00 a month.

Q. May I ask what proportion that was of her total salary? I judge it was a her.

A. I think her salary was $125, is my recollection. I am not sure about those figures.

Q. Did you at that time devote the proportion that 50 bears to 125 of your time to Fidelity matters?

A. I remember once that she filled out some sort of questionnaire, and she said I devoted 90 per cent of my time to Fidelity.

Q. I am asking you what you say, Mr. Marshall.

A. Well, that is hard to estimate, but I devoted a great [fol. 2912] deal of time to Fidelity.

Q. When did this period occur that this was paid? For how long a time?

A. I think it was during the time that I was chairman of the board and that the investment committee meetings were held in my office.

Q. Would it be for a period of three years, then?

A. I should imagine possibly that.

Q. Was it at your orders that it was not set up on the books of the company as a legal matter?

A. Certainly not.

Q. Do you know at whose orders it was?

A. I do not. I don't consider it was a legal matter, however, if I had been asked.

Q. How much were you paid as chairman of the board, Mr. Marshall?

A. I think $200 a month. I think I was paid just what my predecessor was paid.

Q. And for how long did you receive that?

A. I think all the time I was chairman of the board until the court proceedings were instituted. I am not sure about that.

[fol. 2913] Q. Can you tell me why that was not set up so as to be reflected in this ten year fee schedule I asked for?

A. I don't know, except that it wasn't a legal fee.

Q. Mr. Marshall, I have not yet before me—I have asked Mr. Jaegerman to return them to court—the minute book of the board of directors' meeting. In that minute book there was a fee of $15,000 paid to you and some firm of attorneys. Is that correct?

A. Good, Childs, Bobb and Wescott.

Q. You received your proportionate part of that fee?

A. I received a proportion of the fee. That fee was occasioned by litigation which finally went to the United States Supreme Court——

Q. Mr. Marshall, I am not questioning the amount of it——

A. But I want to explain it.

Q. I think it is unnecessary unless his Honor wants to hear it.

A. I want to explain that I wasn't in the litigation all the time, and my recollection is I didn't get half the fee. I only argued the case in the Court of Claims. I got a por-

[fol. 2914] tion of the fee; what it was I don't remember. That resulted in a recovery of nearly $200,000 to Fidelity and the cessation of an annual stamp tax which at certain periods would have run at the dollar rate $25,000 or $30,000 a year.

Q. Now, the question I am interested in, Mr. Marshall, is this. Why was that not set up on the books as a legal fee until I pointed it out to Mr. Gribben and showed him the minutes of the board of directors' meeting, and then the copies, including my own, were corrected to show it?

A. I have no idea. I certainly have never suggested to any officer that any sort of record should be made on the

books of the company. The officers were elected for that purpose, and they go ahead and make the records.

Q. In 1937 there was another fee of $5,000 paid to you and a firm of attorneys. Is that correct?

A. I think there was only the one fee. I think Good, Childs, Bobb and Wescott—that was Secretary of War Good's firm—had litigation in Illinois in which, while I participated, I received no fee.

[fol. 2915] Q. The minute book of the board of directors' meeting shows that a fee of $5,000 was paid to a certain firm and John Marshall.

A. I am very positive, Mr. Palmer, that I only received from Good, Childs, Bobb and Wescott a proportion of the fee they received for the stamp tax. Now, whether that was done in one place or two, I am not sure.

Q. My question is this, Mr. Marshall, that that $15,000 attorney's fee, which was set up on the minute book of the board of directors——

The Court: Mr. Marshall has answered that question. He says that he doesn't know whether that was paid at one time or two times.

Mr. Palmer: I realize that, your Honor, but——

Mr. Ray: May I ask something here? Weren't the checks brought in here and shown that that $5,000 fee did not have John Marshall's name on the check? Wasn't that check exhibited to you, Mr. Palmer, here in the courtroom?

Mr. Palmer: I don't think so, Mr. Ray. I don't want to be too certain of my memory, but I am rather positive it was not.

[fol. 2916] Q. The question I want to ask you, Mr. Marshall—dismiss from your mind the $15,000 fee, as shown by the minute books of the board of directors, made out to the firm of attorneys you mentioned and yourself. Before that time, as shown by the minute book of the board of directors' meeting, there was a fee paid to a firm of attorneys, maybe the same or another one, and to John Marshall, in the amount of $5,000. That fee is not shown on the books of the company as ever having been paid to you or any part thereof, and is not shown on this report as ever having been paid to you, although it is shown on the minute book of the board of directors. That is what I wanted to direct your attention to.

A. Well, I thought Mr. Gribben testified that he had examined the check and that my name was not on the check.

Q. At the board of directors' meeting the fee bill was submitted and authorized to be paid to this firm of attorneys and you. Is that correct?

A. I saw that minute the other day, yes.

Q. And you were present at that meeting?

[fol. 2917] A. I think the minutes show I retired from the meeting while that was being discussed.

Q. That was the $15,000 payment. I am talking about the $5,000.

A. I am just saying, Mr. Palmer, that I have no recollection of ever having participated in any fee with Good, Childs, Bobb and Wescott except the stamp tax fee. What that fee was I don't know. But you will notice from the minutes there were a number of lawyers on the board at that time, including your senior partner, Mr. Koontz, and it seemed to have come as a compromise from Good, Childs, Bobb and Wescott, which was accepted, and I don't think I participated in that negotiation. I know they did the major part of the work and received the major part of the fee.

Mr. Palmer: If your Honor please, I think I will have to defer further questioning along that line until I examine the minute book.

Mr. Huwe: I don't see the necessity for that. An ordinary accountant will make up an account from a check, and it is obvious to anybody. I don't see why there should be any delay on that or any more examination on it, and [fol. 2918] I object to any further questions along that line.

The Court: Overruled. Have you got something else to go ahead with?

Mr. Palmer: Oh, yes, your Honor.

Q. Mr. Marshall, in view of the fact that you received in 1937 a part of that $15,000 fee, why did you write to the Wheeling Intelligencer in June of this year——

A. 1937, you say?

Q. Beg pardon?

A. You say it was 1937?

Q. Yes.

A. That I received the fee in 1937?

Q. I think that is the correct date. As I say, we will have to check that from the minute book of the board of directors.

Mr. Ray: The schedule here shows it was paid in 1934.

Mr. Palmer: Let's get that.

Mr. Ray: Off the record.

(There was a discussion off the record.)

Mr. Ray: The exhibit that you have in front of you [fol. 2919] shows $15,000 was paid these people in 1934.

Mr. Palmer:

Q. Mr. Marshall, were you associated or connected with the firm of Covington, Burling, Rublee, Acheson & Shorb in 1937?

A. I was a special partner.

Q. In December of that year they received $4,612.40, as shown by these figures. Is that correct, to your recollection?

A. They received fees from time to time from Fidelity Investment Association while they were representing it.

Q. In 1938, as shown by this, that same firm received $2,037.19. Is that correct according to your recollection?

A. That is correct. I imagine it is correct.

Q. All right, sir. In view of that, Mr. Marshall, together with your statement as to having received a part of the $15,000 fee, the date of which we will set accurately when the minute books of the board of directors are had, do you think that you should have written the Wheeling Intelligencer, to Mr. Ogden, on Friday, June 20th, 1941, thus: [fol. 2920] "Whether Mr. Fleming or Wheeling attorneys receive fees growing out of this procedure is a matter of no interest to me. Fidelity has been compelled to pay quite a sum of money in the last few years for special legal services, a considerable sum of which has gone to Wheeling attorneys, but I have received none."

A. I think that is a fact.

Q. In the ten year period of 1931 to 1941, Mr. Marshall, this record shows that you received $4,502.16 legal fees. Is that correct?

A. I assume it is correct. I am not questioning the record.

Q. You are not denying it?

A. Oh, no.

Q. The record shows that including the amount which I previously read to you, with Marshall and Forrer's fees

from 1938 to 1941, there was a total paid to you or to your partners of $6,004.65. Is that correct?

A. I assume it is.

Q. You have further stated, of course, about receiving a part of the $15,000 fee. How much did you get of that?

[fol. 2921] A. I cannot remember, Mr. Palmer, but I am satisfied I got less than half the fee, because I only came in the case—the case was started, I think, when I was assistant attorney general, and I only came in the case after it had gone through certain phases and Mr. Good had died.

Q. Did you get as much as $6,000 of that fee?

A. I cannot remember.

Q. This report also shows, Mr. Marshall, that between 1934 and 1938 the firm of Covington, Burling, Rublee, Acheson & Shorb, in which you were a special partner, received $17,144.11 in legal fees.

A. $17,000?

Q. That is what the record shows, Mr. Marshall. I assume it is correct. I didn't make the record, so I can't——

A. Well, whatever the record says I certainly am not questioning.

Mr. T. C. Townsend: What page is that?

Mr. Palmer: It is at the end of the fees of Covington, Burling, Rublee, Acheson & Shorb. This is off the record.

[fol. 2922] (There was a discussion off the record.)

Q. Did you partake of some of the fees that Covington, Burling, Rublee, Acheson & Shorb received during that period of time that I referred to?

A. I think in some instances I did and some I didn't.

Q. Would you be prepared to tell us how much of the $17,144.11 you did receive?

A. Oh, it would be a guess. I should say perhaps a third of it.

Q. And you still say with reference to all that that you received none of the special fees?

A. Will you read that again, Mr. Palmer?

Q. Yes, sir.

A. All right.

Q. "Fidelity has been compelled to pay quite a sum of money in the last few years for special legal services, a considerable sum of which has gone to Wheeling attorneys, but I have received none."

A. Is there any discrepancy in that?

Q. Don't you call this sum of money you received something?

A. I don't call it in the last few years, occasioned by our [fol. 2923] recent difficulties. I worked very diligently during all this period for Fidelity, and I received no special fees for it, just as I say in that newspaper.

Q. You are attempting, then, to say that within the last year or two you received no special fees? Is that it?

A. Just exactly what I said there.

Q. What did you mean by the word "few"?

A. I meant since Fidelity encountered its difficulties which occasioned this extraordinary expense of nearly $600,000, as I understand, and I received no fees for any matters growing out of these recent troubles, although I have worked for them very diligently.

Q. Mr. Marshall, that $600,000 expense which you have spoken of was incurred during the last ten years, as shown by this report.

A. No——

Q. Pardon me. And the troubles you have said began at least as early as 1932, and during that period of time you did receive special fees, didn't you?

A. The troubles——

Q. Will you just answer my question?

[fol. 2924] A. No, I am going to answer it. The troubles I referred to occasioned no litigation. This fee that we received wasn't any trouble; we received it for recovering a stamp tax.

Q. Will you answer my question now, sir?

A. I think I have answered it.

Mr. Palmer: Will the court reporter read it?

The Court: The Court thinks he has answered the question.

Mr. Palmer: May I have the question read for my own information?

(The question was read.)

Mr. Palmer: Will the Court pardon me just a moment till I find in the board of directors' meeting the particular part?

The Court: Well, I assume, Mr. Palmer, that this cross-examination is going to take some little time longer.

Mr. Palmer: Your Honor is correct.

The Court: It is past the noon hour. It is about time for us to adjourn. Unless there is something we particularly [fol. 2925] ought to take up today, I will let it go over.

The Witness: You mean I will have to stay over, your Honor?

The Court: I don't see any other alternative.

The Witness: It works a great hardship on me. I have been here for three weeks waiting for this cross-examination.

The Court: Is there anything else, Mr. Palmer?

Mr. Palmer: Your Honor, I loaned Mr. Ray my booklet of the T. N. E. C., together with the parts of it, and I know he has not had time to read it fully, and if he wants to examine it more fully before I offer those particular parts for the Court's perusal, I will be glad to let him have it.

The Court: Court will adjourn until 9:30 Monday morning.

(At 12:05 o'clock P. M., the hearing was adjourned until 9:30 o'clock A. M., Monday, October 6th, 1941.)

[fol. 2926] Fifteenth Day

Monday, October 6th, 1941, 9:30 O'Clock A. M.

The hearing was resumed pursuant to adjournment of Saturday.

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JOHN MARSHALL, SR., the witness who was testifying at the time of adjournment, resumed the witness stand and continued his testimony as follows:

Cross-examination.

By Mr. Palmer:

Q. Mr. Marshall, over the weekend I have been given the minutes of the stockholders' meetings, the minutes of the board of directors' meetings, and the minutes of the meetings of the executive committee of Fidelity, and I find when I was asking you about two fees in particular, one the $15,000 and on- the $5,000, that I was mistaken in saying that it was shown by the minutes of the board of director's meeting; it should have been shown by the minutes of the executive committee meeting. Now, with reference to that, Mr. Marshall, on page 90 of the minutes of the meeting of

the executive committee as of August 5th, 1932, it is shown [fol. 2927] here that Sanders, Childs, Bobb and Wescott received or were authorized to receive one fee of $1,350.58, and immediately following that it is shown that Sanders, Childs, Bobb and Wescott and John Marshall were authorized to receive a fee of $5,000. Was that fee paid and received, Mr. Marshall?

A. Will you let me see that book?

Q. Surely. (Mr. Palmer hands book to witness.)

Mr. Ray: Your Honor, I again want to object to this because this very matter was up when one of the company employees was on the stand, and he testified about this and testified that regardless of what the minutes showed that the cancelled check did not have Mr. Marshall's name in it. Why should we go into this question when we have had the original records here?

The Court: Overruled.

A. Well, I have no—I have thought about it, Mr. Palmer. I have no further recollection. I do remember that I participated only after this tax refund case got to a certain point, because I think that the record will show that when it was instituted I was an officer of the government and [fol. 2928] couldn't participate. Then my best recollection is I received out of the fee of that firm some proportion, based on the services I had performed. I know that they were in the case for years before I came into it.

By Mr. Palmer:

Q. I am not questioning the propriety of the fee or your propriety in receiving a part of it. What I do want to know, however, is this. The $5,000 as shown paid to Sanders, Childs, Bobb and Wescott and John Marshall is not shown either by the check by which it was paid or the books of the company to have included you in it, and I want to know if that was by your order?

A. Absolutely not. I never, to the best of my recollection, ever suggested during the 20 years that I have been connected with the company any order or any procedure to be taken with respect to bookkeeping.

Q. Then that would answer my further question as to whether or not you know why it did not appear to have your name on it?

A. I do not know. I still say the best of my recollection is I only participated in one fee.

Q. You are not, of course, questioning the accuracy of the [fol. 2829] minutes as shown here, are you?

A. Oh, every once in a while some meeting will make a mistake in the minutes. Very often they have to be corrected, just as we did the last directors' meeting. I think the check would be the best evidence.

Q. In this particular instance are you questioning that this resolution was passed in that fashion?

A. I have no recollection of such a resolution, and of course I don't question it except I say mistakes are made.

Q. What I want to get is whether you concluded that it was a mistake that your name was included in that fee?

A. I am saying that I have no recollection about it one way or the other.

Q. Mr. Marshall, the minute book of the stockholders' meeting shows that on February 8th, 1928, you were the owner of 220 shares of stock of Fidelity company.

A. I don't remember, Mr. Palmer.

Q. You have no reason to think that that is a mistake of any kind?

A. I have none, but that is 13 years ago, and I cannot tell [fol. 2930] you how much stock I owned in any particular year. I know what I own now.

Q. Now, Mr. Marshall, isn't it further true, as shown by the books, that on February 20th, 1938, a stock dividend of 33⅓ per cent was paid?

A. I think there was a stock dividend, which I testified the other day I thought occurred in the early years of the company.

Q. And isn't it further true that your stock holdings were increasing in the same year, on November 22, 1938, until another stock dividend of 20 per cent was declared?

A. I repeat I cannot remember the amount of the stock dividends or when they were declared. I remember there were several dividends paid in common stock and the other in preferred stock. You understand the purpose of that. That was so the stockholders were not taking their money out of the company, but let it there as an evidence of good faith and to strengthen the contractholders' funds.

Q. And isn't it further true, as shown on page 73 of the minutes of the stockholders' meeting, that on November

[fols. 2931-2938] 30, 1929, a further stock dividend of 50 per cent was declared?

A. It may be, but I repeat I cannot remember the amounts, but I am not questioning it.

Mr. Palmer: If your Honor please, from the minutes of the stockholders' meeting we would like to introduce that part of page 15 and that part of the meeting of November 22, 1928, and that part of the minutes of November 30, 1929 which show the stock dividends.

. . . . . .

[fol. 2939] Mr. Palmer:

Q. Mr. Marshall, let me refresh your recollection on that, the other capacities you had at that time. Isn't it true that at the meeting of the board of directors on February 18, 1929, upon motion of Mr. W. H. Bachmann, seconded by Mr. Robert Hazelett, Honorable John Marshall was engaged as special counsel beginning March 4, 1929 at the rate of $1,000 per year?

[fols. 2940-2941] A. If that record shows it—I didn't think it began that early. I was retained by the company at that time—at one time at $1,000 a year. Then I might say incidentally, Mr. Palmer, that at about the same period I was retained by another corporation at $15,000, and I say with the utmost sincerity that during all that period I devoted more time to Fidelity than I did to that company.

Q. My question is——

A. If the record shows that is the $1,000, I testified the other day I did get a retainer of $1,000 a year. Whether it began on a certain day in February I don't know——

. . . . . .

[fol. 2942] Q. Mr. Marshall, when did you first meet Mr. James Fleming?

A. I think I met him at one time when your senior partner and I were in Washington with Mr. Messick discussing ways and means of effecting a reorganization or improving our situation. Mr. Fleming happened to be [fol. 2943] there on other business, and I met him.

Q. Will you tell me what year that was?

A. Oh, it has been in the last six months, I should say.

Q. And that was in this year, if not within the last six months?

A. Certainly within the last year.

Q. Could you give me any more definite date?

A. Well, if you can remember when the government had its settlement with the Ford Motor Company, that would fix the date, because I understood that was Mr. Fleming's business there, representing Henry and Edsel Ford.

Mr. T. C. Townsend: That was within the past ninety days.

A. I mean earlier—not the final settlement, but the situation—when conversations were being held and accord attempted to be reached.

Mr. Palmer:

Q. Mr. Marshall, when did you first meet Mr. Fleming to discuss with him the problems of Fidelity?

A. Well, that was some time later. Mr. Messick advised me that Mr. Fleming had had considerable experi-[fol. 2944]ence with reorganizations, and that he would be a valuable man if we could get him interested to work on our problems; and afterwards I met him. Again I can't remember the date.

Q. Was it before or after the state court receivership proceedings were instituted?

A. I think my meeting with him was before the state court receivership.

Q. Before the state court receivership. Mr. Marshall, I don't know whether you were here present when Mr. Harlan Justice testified. Were you?

A. No, I was not.

Q. Mr. Justice testified in substance—and I would rather counsel or the Court would correct me if I deviate materially from the matter I am about to relate—that Mr. James Fleming, at a meeting in Chicago at which there were present a number of securities and banking commissioners of various states, that Mr. Fleming appeared before that meeting, and as my recollection recalls Mr. Harlan Justice's testimony he said that Mr. Fleming had told that meeting that you had asked him to represent you, to look after your [fol. 2945] interests in Fidelity, because you were its lawyer for one of the largest stockholders. Now——

A. Well, I have no reason to question the veracity of Mr. Fleming. I don't know what he said or what Mr.

Justice said he said, but I certainly have on various occasions expressed my gratitude to him and my appreciation of what he was trying to do. I don't think that I stressed the fact that I was the largest stock holder, but I stressed my interest in this whole general situation, and I think Mr. Fleming has said to others that that was one of the reasons he had become interested on my account. Those things sometimes happen, you know; people get to like each other and do things for each other.

Q. Yes. What I want to arrive at, Mr. Marshall, is when the time came, either before or after the state receivership proceedings were instituted, Mr. Fleming undertook either formally or informally to look after this for you or to help the company out, as you have indicated.

A. Well, I stated it was before the state receivership, because I am thinking——

[fol. 2946] Q. Pardon?

A. I say to the best of my recollection my first—not only my first but my second meeting with Mr. Fleming came before the state receivership proceedings——

Mr. Ray: Your Honor, I want to register an objection to this, because the note I made when Mr. Justice testified was that Mr. Fleming said he had been brought in by the stockholders, principally Mr. Marshall.

Mr. Palmer: Mr. Ray, I asked counsel to correct me if my memory was mistaken.

The Court: It is best to be sure before you quote what has gone into the record, to be sure you are right.

Mr. Palmer: That is why I asked counsel and the Court to correct me. I didn't like to rely on my memory.

The Court: I say it is best not to rely on somebody else to correct you, but to be sure you are right before you ask the question.

Mr. Palmer: If your Honor please, it has been impossible to get a transcript in this hearing. I have to rely on my memory for these things.

Q. Mr. Marshall, when did you and Mr. Fleming first [fol. 2947] begin the discussion that it might be advantageous or for the best interests of Fidelity to have a proceeding instituted in Federal Court?

A. I think it was after it became evident that there were a number of receiverships springing up and after I learned

for the first time the attitude of Securities and Exchange Commission.

Q. Then you would say—I think that letter of the Securities and Exchange Commission was dated May 9th. Isn't that correct?

A. I don't remember.

Q. I am again relying upon my somewhat fallible memory. And it was after that date that you and Mr. Fleming first began discussing federal court proceedings. Am I correct in that?

A. I think so. Your senior partner could give you the full information, because he participated in some of these discussions.

The Court: Are you speaking of Arthur Koontz?

A. I am.

Mr. Reinhardt: Your Honor, May 9th is the date of the letter sent by Mr. Healy to Mr. Marshall, which has [fol. 2948] loosely been referred to as a letter by the Securities and Exchange Commission.

A. Well, I think I stated in my newspaper article it was one of the commissioners.

Q. But the letter that both you and Mr. Palmer have been talking about is the letter sent by Mr. Healy to you?

A. That is right.

Q. Not a letter of the Commission?

A. Oh, I never said that—in fact, I tried to explain that I considered it more or less of a personal letter rather than a letter from the Commission, but I am simply saying that the letter disclosed to me the attitude.

Mr. Palmer:

Q. Now, Mr. Marshall, up until you received that letter from Commissioner Healy, you had been of the opinion that state court proceedings were better than federal proceedings? Isn't that true?

A. Mr. Palmer, I think the record—you have been studying the minute books over Sunday—the whole record shows that with respect to this reorganization, either without court proceedings or with court proceedings, was entrusted [fol. 2949] by the directors to Mr. Koontz, and I followed his recommendations. Now, when Mr. Koontz failed to come in response to my invitation to the Pittsburgh meeting

and the discussion there developed certain facts coupled with my own information as contained in Mr. Healy's letter, I changed my attitude.

Mr. Palmer: Will you read the witness my question, please, and let's see if he will answer it.

(The question was read.)

Q. I think you implied the answer to that question is yes. Is that right, Mr. Marshall?

A. I have answered the question. I don't think I can say, in fairness, without explaining, that I favored it.. I voted for it on the recommendation of counsel who had been entrusted with the matter, but without full information from said counsel.

Q. Now, let me see if I understand that. You relied upon the judgment of Mr. Arthur Koontz and his firm——

A. I saw no—I don't want to imply that I was just blindly following what Mr. Koontz said, although I had the highest regards for him and we had been friends, [fol. 2950] as I supposed, for twenty years; but I saw no reason at the time to take a different course than the one he suggested. I was heartily in accord with him, and the minutes show that the directors voted that way unanimously.

Q. Mr. Koontz had not been a director of the company from the middle part of 1940 up until that time, had he?

A. No, but he had been counsel acting for Fidelity before the Commission and before the state departments as well.

Q. But you relied to a large extent upon his judgment and recommendation?

A. I think I have stated fairly just my situation in that respect.

Q. And in the meeting of April 7th, you, I believe, made a motion that the firm of Koontz & Koontz be appointed attorneys for the debtor in the state court proceedings?

A. That is correct. I had every confidence in them.

Q. Mr. Marshall, isn't it true, if you had seen—or is it not true—that you had seen the letter of March 25th written by the State Auditor to Mr. Koontz?

[fol. 2951] Have you seen the copy of that introduced in evidence here?

A. No, I have not.

Mr. Palmer: Will you get me Exhibit 94, please, Mr. Price?

(Exhibit 94 was handed to the witness.)

A. When I first started to read that letter I thought I had. I am not sure, Mr. Palmer, but I do know this, that I was advised that Mr. Sims had been in conference with the Commission, and I had assumed that all the parties were trying to work out the best solution.

Q. If you did not see a copy of that letter, at least you had been given, by information, the substance of the contents thereof? Is that true, Mr. Marshall?

A. I have a recollection that Mr. Koontz wrote me a letter once from Mr. Sims' own office some time, which I regarded as a very serious—which I thought was a very serious letter; but I really do not recall that it was suggested by Mr. Sims that Mr. Koontz explore the—as I think that letter indicates—the possibilities of reorganization, although I have no reason to doubt it. If Mr. Koontz, for [fol. 2952] example, would say that he had showed me the letter, I would say all right, but I really have no recollection of that part of the letter.

Q. Mr. Marshall, Mr. Koontz became a director of the company in the early part of 1932? Is that your recollection?

A. I don't remember. I know he has been on a good while.

Q. I think the board of directors' and minutes of the executive committee do not show his name appearing on them before March or April, 1932, and then on that meeting of July 9th, and perhaps one meeting before it shows his appearance. Would that be substantially correct?

Mr. Ray: Your Honor, if I am not mistaken, he brought out Mr. Koontz's tenure on the board by Mr. Risley, and I think he brought out the same question by another witness. It should be in by this time.

Mr. Palmer: You are correct, Mr. Ray, but I want to refresh Mr. Marshall's recollection as to the tenure of Mr. Koontz.

The Court: What bearing does that have on the inquiry?

[fol. 2953] Mr. Palmer: Because I am going to ask him certain things based on that recollection.

The Court: On his recollection of when Arthur Koontz became a director?

Mr. Palmer: Yes, not specifically on that but——

The Court: It seems to me you can just assume that without asking him those questions, because it is already clearly in evidence, and the minutes would show when it occurred.

Mr. Palmer: After Mr. Koontz came on the board of directors, do you know at whose instance that was, Mr. Marshall—were you instrumental?

A. Well, I have just been sort of smiling, Mr. Palmer. I think that I have heard that he had about the same sentiments with respect to Fidelity and me that you say Mr. Fleming did, and I have always appreciated it.

Q. He became interested in it because of his personal friendship with you?

A. That is what I have always understood, and on many occasions expressed and tried to show my appreciation as well.

Q. And to your knowledge he worked long and diligently [fol. 2954] for Fidelity?

A. I had always assumed so.

Q. Well, you had knowledge of a large amount of that, without having to assume it, did you not, Mr. Marshall?

A. I don't see what my feelings then or now with respect to Mr. Koontz—I would just rather not discuss that, please.

Q. It is a question of your knowledge——

A. I know Mr. Koontz put in a great deal of time for Fidelity, if that is what you mean.

Q. And rendered some very valuable service for a good many years?

A. He was very faithful in his attendance at the meetings and always evinced a great interest in Fidelity.

(There was a discussion off the record.)

Q. Mr. Marshall, how familiar were you with the difficulties of Fidelity from the first of January up through the 7th or 8th of April, 1941?

A. This year?

Q. Yes.

A. Well, I tried to be familiar with them. It now de [fol. 2955] velops there were several things I didn't know.

Q. Such as, Mr. Marshall?

A. Well, principally the information I received from Mr. Healy's letter—Mr. Healy's letter.

Q. You didn't know of the things in Mr. Healy's letter until you received it? Is that correct?

A. I had understood that someone—I want to be very meticulous—I heard people talking about what the Commission said. I have always assumed that the Commission acts only when the Commission does something, but my information definitely was that someone in the Commission had suggested that we needed—and I remember it distinctly because of the expression—that we needed the umbrella of the court, but it was only when Commissioner Healy wrote me that I understood that it wasn't just any old court, that they had a court in mind.

Q. You are speaking of that part of Mr. Healy's letter which the Court has read in evidence, and no other part?

A. Certainly. No matter how you may consider the letter, I got that impression.

Q. Mr. Marshall, isn't it true that after you received Mr. [fol. 2956] Healy's letter you wrote back to him?

A. I think I did. I am sure you have all those letters in your files, or Koontz & Koontz.

Q. Yes, sir, Mr. Marshall, and I might explain to the Court—I say this in fairness to Mr. Marshall and myself—in the hall of the courtroom, after court adjourned on Friday, and after I had stated to the Court that I had not seen the original letter or a copy thereof of Mr. Healy or his reply, that Mr. Arthur Koontz deemed those letters confidential, Mr. Marshall told me that they were letters from general counsel to field counsel, and if I had not seen them I should see them; so with that authorization from Mr. Marshall I have since seen that letter and Mr. Marshall's reply thereto. Until then I had not seen the letter, I want to assure the Court.

The Witness: I don't think, Mr. Palmer, that is quite accurate. I didn't say you should see them. I asked you if you had seen them. You said you had, only read parts of them, because you thought they were confidential.

Mr. Palmer: You further said if I had not seen them you [fol. 2957] wondered why I had not seen them.

The Witness: You told me you had seen them.

Mr. Palmer: Didn't I tell you, Mr. Marshall, in the hall of the courtroom, when you asked me why I told the Court

I had not seen the letters, that Mr. Koontz had shown me a part of one letter and the rest was confidential?

The Witness: No, you didn't say Mr. Koontz had shown them to you; you said you had seen a part of them.

Mr. Palmer: At any rate, if the Court please, I had not seen this other letter until after that statement was made that it was from general counsel to field counsel.

The Witness: That is not entirely accurate. That letter wasn't sent around to counsel promiscuously. We have lots of counsel. That letter was sent to Mr. Koontz because Mr. Koontz was aware of what I was doing in this matter and because he had been entrusted particularly by this company with this phase of our situation.

The Court: The Court is entirely in the dark about what letters you are talking about. You referred to one letter, [fol. 2958] the letter from Mr. Healy to Mr. Marshall. I understood Mr. Palmer had never seen that, but had been told something about it which afterwards proved to have been false. If there is any other letter I am in the dark.

The Witness: If it please the Court, he also asked if I had not written a letter to Commissioner Healy to get this response.

Mr. Palmer: No, I am talking about another letter. After Mr. Healy wrote you you wrote a reply to Mr. Healy?

The Witness: Well, I wrote first a letter to Mr. Healy which occasioned this letter to me.

Mr. Palmer: Well, I have never seen that, Mr. Marshall. I don't know that Mr. Koontz even has a copy of it. If you would like to produce that letter I would be very glad to have it.

The Witness: I have not wanted to produce any of this correspondence, because I felt it was personal.

Mr. Palmer: I do now speak of a letter, your Honor, which Mr. Marshall said he wrote in reply to Mr. Healy, and on the subject which the Court has read in evidence.

The Court: What is the question about that letter?

[fols. 2959-2976] Mr. Palmer: I wanted to explain to the Court why I had not seen them. My question, Mr. Marshall, is, in your letter of May 10th to Mr. Healy did you not say that while you did not know of the attitude of the Securities and Exchange Commission, or words to that effect, and I would like to have your copy of the letter produced so that I could quote it accurately—that if you had

had that knowledge you would still have approved the other proceeding?

A. I don't remember that.

Q. Beg pardon?

A. I don't remember saying that.

Q. Will you produce your copy of that letter, please, Mr. Marshall?

Mr. Ray: Have you got a copy of it?

Mr. Palmer: I don't know.

Mr. Ray: Where are we getting——

The Court: Do you object?

Mr. Ray: I do.

The Court: Sustained.

* * * * * * *

[fol. 2977] Q. Mr. Marshall, did you play a large part in selecting those who became members of the board of directors, in helping to ask prominent people to serve upon the board of directors?

Mr. Huwe: Your Honor, I object to that because we just went into it just last Saturday, and I think that has been fully covered.

Mr. Ray: With Mr. Risley and with another witness.

The Court: I am going to permit one answer here, but I am not going to permit a lot of detail to be asked this witness that will simply cumber the record. He may reply whether he did or not, and then let's leave it.

A. I think I can answer in a sentence. When I first came on the board it was entirely a West Virginia proposition. After we launched out into other states frequently I would be the only West Virginian that knew people in those states, and I did in some instances, many instances, secure friends that I thought would be valuable directors for Fidelity to go on the board. Many other valuable directors I had nothing to do with.

[fols. 2978-2992] Mr. Palmer:

Q. Mr. Marshall, isn't it true that you knew that when state court proceedings were to be instituted the Auditor of West Virginia was going to ask the other states to appoint receivers in those states to freeze the funds there?

Mr. T. C. Townsend: We object. That has been gone into many, many times.

The Court: I don't know whether this witness has been asked the question or not.

Mr. T. C. Townsend: Well, probably not by this witness.

The Court: Overruled.

A. I understood that Mr. Sims was going to seek injunctions, and I had some assurances that he would very probably be successful.

Mr. Palmer:

Q. My question is whether you knew that Mr. Sims would wire to other states and ask them to appoint——

A. Yes, yes. I believed in this proceeding at first.

Q. Sir?

A. I was heartily in favor of the state receivership at first.

. . . . . .

[fol. 2993] Mr. Palmer:

Q. Mr. Marshall, what, if any, part did you play with reference to having the meeting in Pittsburgh of June 3rd called?

A. I approved of it.

Q. It was discussed with you, I understand; from your answer, before it was called?

A. Yes, sir, discussed where it should be held—where the most convenient place would be.

Q. And who so discussed it with you?

[fol. 2994] A. I think it was Mr. Messick; I would not be certain.

Q. How long prior to the meeting?

A. I don't remember that.

Q. Would it be longer than a week?

A. I don't remember.

Q. Would it be longer than a month?

A. Oh, no.

Q. Mr. Marshall, on September 17, 1941, did you know that Mr. A. L. King was summoned as a witness in this present proceeding?

A. I heard he was and testified.

Q. Did you meet him in the hall and request that he attend a board of directors' meeting to be held that day?

A. Yes, sir.

Q. Did you and Mr. Fleming further meet with him and have an extended discussion—more or less extended—in which you asked him to attend the board of directors' meeting?

A. I first spoke to him and asked him if he had resigned as both secretary and director, and he said he had resigned [fols. 2995-2998] as both; but of course, his resignation had never been accepted, and I felt he was eligible, and I found that he was taking a position that I couldn't understand, and I asked him to talk over the situation with Mr. Fleming, that there must be some misunderstanding. He said we had treated Mr. Koontz improperly and he wasn't going to attend the meeting.

. . . . . .

[fol. 2999] Mr. Palmer:

Q. Mr. Marshall, can you tell us, if you know, why the tellers did not set forth the names of the persons present at the meeting of October 3, 1941, together with the shares of stock they represented, when, so far as I can discover, it was the first meeting of stockholders for many years at which said practice was not followed?

A. I don't know why. I know that it took almost all morning to do what they did, and I know I appointed on that committee three employees of the company, two of whom had acted at previous meetings for that same duty.

Mr. Palmer: If your Honor please, it is not shown by the minutes of the meeting of the board of directors' or the stockholders' meeting what persons were present and what stock was represented other than Mr. Philip D. Paull acting for the tellers' committee reported that of a total of 10,233 shares of stock 9,987 were present, by proxy or trustee, and such representation constituted a quorum.

The Witness: Mr. Palmer, the tellers' report is in there and shows the stock represented in person, the stock represented by trustee, and the whole report. It does show [fol. 3000] that.

Mr. Palmer: That is fine. Will you show that to me?

Mr. Ray: It is right at the end of the minutes.

Mr. Palmer: The part shown to me has already been read in evidence, which merely shows preferred stock, number of shares, common stock, number of shares, but does not state the names. Now, my question to Mr. Marshall was as to why the names were not set forth, and my remarks which I was about to direct to the Court when I was interrupted, were that it is not shown who was present representing which stock, so that it can be checked whether that stock was correctly represented and correctly there, and it is the first time in at least a good many years at which that practice was not followed.

The Court: Well, the witness has advised me that a committee was appointed for that purpose. Do you know why they did not detail it?

The Witness: I do not know, unless it was because of the time element, your Honor. We were told that this Court wanted that report in that day, and I didn't even wait for lunch. Just as soon as I could get the material [fol. 3001] I started out.

. . . . . .

[fol. 3002] Mr. Palmer:

Q. Mr. Marshall, it is true, is it not, that as general counsel of Fidelity you passed upon and approved all of the fees paid to Mr. Arthur B. Koontz or the firm of Koontz & Koontz or their predecessors for legal services rendered?

A. I don't know about that. I was supposed to, but I don't know.

Q. You were supposed to.

A. I say our firm was supposed to.

Q. So far as you know it was done in the proper manner?

A. I don't know. I mean I would have no way of knowing. It is conceivable that a fee might be paid by an officer without my approval. I have known it to be done.

[fol. 3003] Q. In connection with Mr. Koontz?

A. Not in connection with Mr. Koontz.

Q. So far as you know, you never raised any objection to any fees paid Mr. Koontz?

A. I never raised any objection. I have never made any check whether I approved. In a great many cases I tried to get lawyers to reduce their bills, and if I finally ap-

proved it that was because I was unsuccessful. I tried to be conscientious.

Q. I am speaking only about the Koontz fees. Have you discovered in your notes any place where you raised any objection to them at any time?

A. No fee ever rendered by Koontz & Koontz that I objected to.

Q. And when it was approved by a board of directors' meeting or executive committee meeting you never raised any objection at any time?

A. I am sure that I never did.

Q. And you were familiar personally at least to a large extent with the legal services that Koontz & Koontz were rendering?

[fols. 3004-3012] Mr. T. C. Townsend: We object, your Honor. That has all been gone into very thoroughly.

The Court: Overruled.

A. I kept very closely in touch with Mr. Koontz.

Mr. Palmer:

Q. So that in connection with the bills you had a general idea of the work that had been done by Mr. Koontz and his firm?

A. The ones I approved.

Q. And you stated that so far as you know you raised no objection to any of them?

A. I never raised an objection, I am positive, to any bill that was ever presented to me from Koontz & Koontz.

* * * * * * *

[fol. 3013] JOHN MARSHALL, recalled, testified as follows:

Q. It is true, as shown by the minutes of the corporation, that your son, John Marshall, Jr., is and has been a director for some period of time, is it not?

A. That's correct.

Q. It is also true, is it not, Mr. Marshall, that immediately following the appointment of State Court receivers, your son, John Marshall, Jr., was dismissed as an employee of the State Court receiver?

A. That is correct.

Q. Mr. Marshall, is it a fact that after Mr. Messick became chairman of the board, he placed much more substan-

tial duties upon your son, John Marshall, Jr., than had the officer theretofore—much more substantial and responsible?

[fol. 3014] A. The only—I can't answer definitely to that. I know that Mr. Messick once undertook a survey of our securities and so forth, and my son——

Mr. T. C. Townsend: Excuse me. I want to get that question, if the Court will pardon me.

(The question was read.)

Mr. T. C. Townsend: I can't see where it is leading to—I can't see where it is leading to anything material.

The Court: Let it be answered.

A. I know that Mr. Messick undertook to make a survey, which he testified about here recently, of our portfolio, and how he consulted experts and bankers and so forth, and in that study he had my son, who had trained along that line with J. P. Morgan & Company and had majored in economics in college, work on that situation for several months. I know with respect to that, he added that responsibility to him. I think he also asked him to make surveys or ascertain if expenses couldn't be reduced. I think he did that.

Q. Those had been more substantial duties and more important duties than your son had theretofore been performing, is that correct?

[fol. 3015] A. I can't say about that.

Q. Mr. Marshall, did the fact that Mr. Messick had seemed to realize the capabilities of your son, after he had been discharged by the State Court receivers play any part in your change of opinion from wanting it in the State Court to wanting it in the Federal Court?

A. Not at all.

Q. Mr. Marshall, after the meeting in Pittsburgh, was there a discussion had that Mr. Fleming was to present as the attorney for the debtor the petition to the Southern District Court of West Virginia?

Mr. Lauritzen: Mr. Steussy has come here, the witness we expect to introduce. I want to ask counsel if there is any objection to having him in here?

Mr. Ray: He might wait outside like the other witnesses did.

Mr. Palmer: Is there a question there?

(The question of Mr. Palmer was read.)

A. I don't know that that was specifically discussed. As I understood it, the institution of this proceeding was authorized, and not only my understanding was—but I arranged for them to see particularly my brother in south-
[fols. 3016-3020] ern West Virginia, to discuss the whole situation with him. I don't think a meeting was needed. I was general counsel. I could approve of Mr. Fleming acting without any discussion of the board of directors. I am satisfied that the minutes will not show that that specific action was taken.

Q. My question was as to whether there was a discussion at the meeting in the sense that Mr. Fleming was to be the attorney to present the petition for the debtor in this Court?

A. I don't think so.

Q. Now, was there any discussion, Mr. Marshall, at that meeting that Mr. Fleming and Mr. Messick were to be employed by the trustee to aid the trustee in reorganization?

A. I am certain that wasn't discussed, although Mr. Messick, you understand, had been appointed by the board of directors the chairman of the Committee on Reorganization with power to select persons, and I knew he had asked Mr. Fleming to be associated with them. The question that they were to be employed by the trustee I am sure wasn't discussed.

[fol. 3021] Q. Mr. Marshall, in your letter to Judge Healy of May 10th, did you state to him these words: (Reading) "I was advised that as soon as the insurance commissioner of West Virginia learned our plan had not been approved by the Securities and Exchange Commission, he took steps which subsequently resulted in the appointment of receivers. I think it only fair to say, however, Judge Healy, that if I had had a choice in the matter I would have preferred the course which has been taken." I asked Mr. Marshall [fol. 3022] about that in substance without having the exact words, and I submitted that at that time, if he had answered, his answer would be Yes. I wanted the exact words, your Honor.

The Court: I don't recall any question this morning or ruling or why it was made, but I will permit the witness to answer.

A. I assume that that is correct. The record bears out the fact that I preferred the State Court. That is the reason

I voted for it in the first meeting of the board of directors, on the representations and information I had at that time.

Q. And the following sentence was this, Mr. Marshall:

Mr. Ray: How far is he going with this letter?

The Court: I don't know.

The Witness: It is a private letter.

Mr. Ray: I object. If he is going to read the letter——

The Court: Let's see what it says.

Mr. Palmer: The following sentence was this: (reading) "I have reasons for this which I do not care to put in writing. If the matter is of any interest to you, and we are being confronted by this situation, I would deem it a favor to be permitted to explain them."

[fol. 3023] A. I remember saying something like that.

Mr. Palmer: All right, sir.

Mr. Townsend: Read the answer.

(The answer was read.)

Mr. Ray: May I see that? (Referring to paper)

Mr. Palmer: I would prefer not to, because the Court has deemed that some of those letters are confidential—unless Mr. Marshall says he would be glad to. Otherwise I would not like to show him the letter.

The Court: The Court's ruling on the confidential nature was due entirely to Mr. Marshall.

Mr. Palmer: Yes.

The Court: It seems that it wasn't so confidential after all, if you have it in your file.

Mr. Palmer: If Mr. Marshall desires that I show it to Mr. Ray——

The Witness: I prefer not to. I regarded—I wasn't writing the Commission; I was writing the Commissioner. I regarded the whole file as confidential. On the other hand, the firm of Koontz & Koontz had been appointed by the directors to represent us in this matter, and I felt they [fol. 3024] should have the benefit of any information that I had.

Mr. Palmer: Then with that, your Honor, I think the only pertinent part, which I have read, would be the only part which should be given to Mr. Ray.

Mr. Ray: I don't think Mr. Palmer should be permitted to bring a letter that counsel haven't seen, read part of it

in the record and ask questions about it without letting counsel see it. I therefore move that the questions bearing on this letter be stricken from the record.

The Court: The privilege is Mr. Marshall's. If he wants the letter exhibited to counsel, it should be. If he doesn't, it shouldn't.

Mr. Palmer: Let the record show I have no objection to it, but believe it is a privilege with Mr. Marshall.

The Witness: If Mr. Palmer is to read parts of it, there is no reason why Mr. Ray, representing the debtor, should not see it.

Mr. Palmer: Let the record show that Mr. Palmer has now presented to Mr. Ray the papers about which we are speaking.

The Witness: I think in fairness I ought to say, the reason I didn't care to put the matter in writing—certainly [fol. 3025] it has no relation to this Court, because since that time—I never knew—I never did see Judge Moore until I came in this Court room. It was outside—it had nothing to do with this Court is the reason I have for my actions.

Mr. Ray: May Mr. Marshall be excused from the witness stand for a moment while I ask him a question about this?

The Court: All right.

(Witness leaves stand and confers with Mr. Ray.)

Mr. Palmer: Your Honor, I withdraw until Mr. Ray wants to ask about this letter, and then I will resume.

The Court: All right.

(Witness resumes stand.)

Mr. Ray: Mr. Marshall, just now when you withdrew from the stand I asked if you had any objection to filing two sentences in this letter of May 10th, and you told me you did not.

A. I understood they were really parts of what had been read.

Mr. Ray:

Q. The sentence immediately preceding the one which Mr. Palmer read. May I read them into the record?

A. I have no objection.

[fol. 3026] Mr. Ray: (Reading:) "I have carefully read the paragraphs of your letter referring to the efforts of

Fidelity and the Commission to reach an accord. The only thing I did not understand was that the Commission had coupled with its refusal to approve the plan of reorganization submitted the further recommendation that the Association resort to the reorganization procedure of Chapter 10 of the Bankruptcy Act. In any event, the Association had no choice of decision."

Q. Mr. Marshall, are those the two sentences which I have just read in the paragraph immediately preceding the sentence which Mr. Palmer read?

A. That is my understanding.

Mr. Palmer: If your Honor please, I have something that I would like to ask the Court, but I hesitate greatly to ask to be permitted to go into the record. The Court has on several occasions reprimanded me as counsel for asking for the production of a letter which the Court felt, after a comparison of a newspaper article or letter, was improper to be brought in or even if proper, it was of such relative unimportance to raise such a furor about, and I have pro-
[fol. 3027] ceeded in accordance with the Court's reprimand in that respect. I felt somewhat embarrassed about it. Your Honor, having had this letter before me for the first time where I could compare the two, there is to my mind a distinction which I would like to be permitted to point out to the Court and to ask Mr. Marshall about, if the Court doesn't feel that counsel is being improper to present this matter that the Court has ruled so conclusively about.

The Court: Let's see what it is.

Mr. Palmer: I would first like to read, your Honor, the pertinent part of the letter of Mr. Healy——

Mr. Ray: That is already in the record.

Mr. Palmer: I am just reading it to the Court.

(There was a discussion off the record.)

Mr. Palmer: My distinction is this, your Honor, that in one, the Commission doubts as a practical matter whether any plan could be put into effect without the Chapter 10 proceeding, and said it would not approve of any in any other Court which didn't come up to the standards of Chapter 10. The letter of Mr. Marshall says that the Commission flatly says, no matter what happens, it wouldn't approve of any plan that went through unless a Federal Court [fols 3028-3039] had done it. Your Honor may be correct

that I am splitting the northwest corner from the north side of a hair from the south. I do deem it a substantial difference; as Mr. Marshall put in his letter, it would leave an alternative for the Federal Court proceeding, whereas the Commission, in stating its tentative position, would leave a way open for the State Court proceedings that were then going on.

The Court: That distinction seems to me so trivial that it is practically non-existent, and I feel that if I had been in Mr. Marshall's place, I would have drawn the same conclusions from the letter he drew and expressed in his letter. That's why I have said what I have on this record about that letter.

Mr. Palmer: Your Honor, I am sorry I misinterpreted. I thought there was a substantial difference or I would not have raised the question. In view of the Court's ruling, I will make no more mention of the matter.

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[fols. 3040-3046] Q. Didn't you have conferences with Mr. Messick and Latta in February 1941 about these plans?

A. I can't remember the dates. I remember one further fact that Mr. Latta was recommended by the Lincoln Life Insurance Company.

Q. Of Fort Wayne, Indiana?

A. Yes. I think they gave a number of names of persons that would seem to fill this specification, and Mr. Latta seemed to be the highest of any recommended.

Q. What special qualifications did he possess?

A. Well, he had been in reorganization matters and was acquainted with the same type of business that we were in and in the insurance business that we would go into.

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[fol. 3047] Henry M. Steussy, called as a witness, having been first duly sworn, testified as follows:

Direct examination.

By Mr. Lauritzen:

Q. You are Mr. Henry M. Steussy?

A. That is right.

Q. (Spelling) S-T-E-U-S-S-Y?
A. Yes.
Q. Where do you live?
A. At Milwaukee, Wisconsin.
Q. How old a man are you?
A. Forty-eight.
Q. Were you formerly connected with the Fidelity Assurance Association?
A. Fidelity Investment Association.
[fol. 3048] Q. Now known as Fidelity Assurance Association?
A. That is correct.
Q. When did you first become connected with Fidelity?
A. April 7th 1931.
Q. Prior to becoming connected with Fidelity, what was your business?
A. I was with the Provident Life Insurance of Philadelphia.
Q. In what capacity?
A. As an agent.
Q. Had you enjoyed some success in that line of endeavor?
A. I did.
Q. Now, Mr. Steussy, will you just relate in your own words, if you will, how you first heard about Fidelity and what it was that induced you to take up work with it?

Mr. Ray: I object. That cannot be material.
The Court: Sustained.

Mr. Lauritzen: Mr. Steussy, when you became associated with Fidelity, in what capacity was it?
A. I was the manager of the Wisconsin office.
Q. That meant that you had charge of the Wisconsin salesmen?
[fol. 3049] A. That's correct.
Q. Now, through whom did you become associated with Fidelity?
A. Mr. J. H. Pulfer, who was the assistant supervisor of the company.
Q. And was it Mr. Pulfer that explained Fidelity's plan to you?
A. That is correct.
Q. Was there anything in particular about Fidelity's plan that attracted you to it?

Mr. Ray: Your Honor, I think that is immaterial.

The Court: Sustained.

Mr. Palmer: If your Honor please, if the Court will allow another counsel to be heard on that objection, I believe the form of the question is improper, but would it not be material as to what Mr. Pulfer or another officer of the company told him about Fidelity that made him decide to go with it, on the question of whether or not, if it would be reorganized, other salesmen could be had upon that same proposition, or whether that proposition would be one that would now be impossible to comply with or whether that particular explanation by the company was an erroneous one.

[fol. 3050] The Court: No. A reorganization wouldn't have any bearing on the old setup. That is, what I mean by that is that if there are objectionable features about the representations made to salesmen by the old company, they certainly wouldn't be carried over into any reorganization.

Mr. Palmer: That was my point, your Honor. Unless we know what they were, it would be impossible to say that they might not be carried over.

Mr. Lauritzen: It is really unimportant.

The Court: Then why ask the question.

Mr. Lauritzen: Mr. Steussy, did you become aware that the company operated under a deposit law in Wisconsin?

A. Very definitely.

Q. Was that one of the reasons you were attracted to it?

A. I didn't go with them until I had full time to check it up and satisfy myself as to the safety of the sale of the contracts to our Wisconsin people.

Q. Is it a fair statement that that was the chief reason why you took up——

The Court: Mr. Lauritzen, I sustained the objection to these questions, and while counsel is not objecting to it now, I think that I ought in my own motion prevent you from asking the question. It is immaterial why this witness went [fol. 3051] with Fidelity. That certainly is an understandable ruling.

Mr. Lauritzen: I think the materiality of it will be evident in a moment. Now, what was the status of Fidelity in Wisconsin as to total outstanding liabilities when you came with it?

Mr. Ray: If he knows, your Honor.

Mr. Lauritzen:

Q. If you know.

Mr. Ray: And if he has had charge of the books and records which would show that his information is accurate. I don't think he should guess at it.

Mr. Lauritzen: Strike the question.

Q. Mr. Steussy, when you took up your association with Fidelity, was information given to you as to the total Wisconsin liability?

A. I was told there was less than twenty thousand dollars.

Q. Did you later ascertain that to be a fact by reports that you received or copies of reports sent to the Banking Commission of Wisconsin?

A. That is correct.

Q. When you first took hold of the Wisconsin office, how many salesmen did you have?

[fol. 3052] A. Two.

Q. Now, tell us what you did with respect to recruiting a sales force; how you went about it and what results you obtained.

Mr. Ray: Your Honor, I submit that that is immaterial to the issue in this case.

The Court: Point out its relevancy.

Mr. Lauritzen: The point is that Mr. Steuss was in charge of developing one of Fidelity's largest and most successful sales forces, and with that as a background, his testimony will certainly have a great deal more significance than if he were just some stranger to this entire proceeding.

Mr. Palmer: May I suggest that the qualification of the witness is to show the Court his background of experience and learning upon which later questions would be based.

Mr. Ray: Questions based upon the issue in the case?

Mr. Palmer: In other words, if you put a doctor on the witness stand——

Mr. T. C. Townsend: You ask him about a medical proposition.

Mr. Palmer: If you want to ask this witness about sales [fol. 3053] later of a company to be reorganized, then you would have to ask him about what his experience has been in the selling field and how he arrived at it. It is a qualifying question, your Honor.

The Court: Do I understand that this witness is an expert witness, or does he know facts?

Mr. Lauritzen: I would say he would come in both categories. If the gentlemen will just let me develop his connection with this company. I don't think it is fair.

The Court: The thing I am interested in, is whether your line of examination is pertinent to the case. If it is, we will permit you to go along with it.

Mr. Lauritzen: This witness has had a background of experience with this company of a great many years, and he was a high executive. Surely he is going to be a witness that this Court is going to listen to with respect to expressing opinions on what the future of this company may be, or what can be done or could be done.

The Court: Are you going to use this witness as an expert witness or a witness to facts?

Mr. Lauritzen: I think he would be a witness to facts.

The Court: Then how are the facts pertinent?

[fol. 3054] Mr. Lauritzen: As to his contact with this company?

The Court: Yes.

Mr. Lauritzen: Why, just this.

The Court: You can't bring in every salesman all over the United States and show that he was a salesman for this company.

Mr. Lauritzen: This man is a managing director of the company in charge of sales in a large area, in the largest office they had in the company.

The Court: I will sustain the objection to the question.

Mr. Lauritzen:

Q. Mr. Steussy, were you successful in recruiting a large number of salesmen for Fidelity and did you do it?

Mr. Ray: Your Honor, I submit that is irrelevant.

The Court: Sustained. I don't care to argue. I have ruled.

Mr. Lauritzen: If the Court please, I will offer to prove that Mr. Steussy built up a very large force of salesmen in the State of Wisconsin through his efforts in recruiting them; that he became extremely familiar with that work and was extremely able in that work, as demonstrated by [fol. 3055] his record with Fidelity. I don't suppose anyone will dispute it that by 1938 he had 225 men working

for him in the State of Wisconsin. Now, if the Court will permit, I would like to ask him what sales volume he obtained in Wisconsin.

The Court: If you will show me the materiality of it I will permit you to get it on the record. Since I think it is not material, I have sustained the objection and you may put it in the form of a proffer.

Mr. Lauritzen: May I say that Mr. Steussy will later testify as to a business connection he has since he left Fidelity, and with regard to efforts that he has made in trying to sell similar contracts for a life insurance company. There has been voluminous testimony introduced by the debtor here as to the possibility and desirability of Fidelity continuing in some form of a life insurance company. This witness is going to be a man who will tell you exactly what his experience in that very field has been.

The Court: Mr. Lauritzen, I have asked you twice about whether this witness is to be used as an expert witness or a witness to facts. You have told me that he is to be used as a witness to facts. I have ruled as to the facts. They are [fol. 3056] immaterial and therefore I sustain the objection. If you are simply qualifying him as an expert witness, and that is the sole bearing of the testimony that you are trying to elicit, and that is the sole purpose of the testimony, then my ruling would be different, because probably it is material in qualifying him as an expert witness.

Mr. Lauritzen: I don't think we understand each other. I will say that I believe Mr. Steussy is an expert witness, and if the Court will permit me, I would like to qualify him as such. If I fail in that, then these objections will be made and sustained on the same ground your Honor has already ruled.

The Court: The question will be permitted for the sole purpose of qualifying him as an expert witness.

Mr. Luaritzen:

Q. Will you now tell us what methods you pursued and what you did and what the results were in recruiting your sales force in Wisconsin on behalf of Fidelity?

A. From the beginning?

Mr. Ray: Just a minute. I object.

The Court: I didn't say I would permit your question [fol. 3057] to be used——

Mr. Lauritzen:

Q. Then tell us what you did and what results you achieved. Tell us what results you achieved.

The Court: The only question that this Court will permit along this line is for a qualifying question, to qualify this witness as an expert. You may ask him how many salesmen he got together, whether he operated, and the length of time he operated with those salesmen, and the degree of success that he had; but as to details of his methods and so on, that has nothing to do with the case.

Mr. Lauritzen: That is what I want to bring out. How many salesmen did you finally have working under you in Wisconsin?

A. The first year I developed an organization of about forty salesmen—forty-two, I think, is the correct figure. The second year that amount grew to some sixty-odd. Then that brought us to 1932. Then we lost a few—but from 1934, that organization kept growing, and in 1938 I had a license with the State Banking Department of Wisconsin and the northern peninsula of Michigan. I had some 225 men. The volume of business had reached, in the last month I operated, over a million dollars per month.

[fol. 3058] Q. Now, Mr. Steussy, did you have occasion, while you were with the company, to have statistics and tables prepared relative to the efficiency of your group of salesmen as measured against the efficiency of other salesmen within the Fidelity Association?

Mr. Ray: We object.

The Court: Overruled.

A. We had tables of all district operations furnished us monthly.

Q. And how did your men compare in production and efficiency with the general run of salesmen?

A. Well, I think that our office without exception ranked in top position in all, measuring what they did by form of record, an average of nine months out of every twelve for each year that I was in the company, from the 7th of April 1931 to the 31st of December last year.

Q. What were some of the tests of efficiency that you used?

A. Volume per man in the organization, volume per producer, collections per unit, persistency of the business, the size per unit sale. I think that covers it.

Q. Will you tell us the nature of your arrangement with [fol. 3059] Fidelity? What kind of a contract did you have?

A. When Mr. Pufer hired me, he had the territory west of Ohio. He was the supervisor. He hired me under a manager contract. In 1934, I believe it was, when Mr. Evans was made director of agencies, he gave me a direct contract in May, giving me the entire territory direct from the home office by direct contract.

Q. Now, you received a commission on the production of your men? Is that correct?

A. That is correct.

Q. That's all you received?

A. The company in its contract with me undertook what we called "stationary expense," such as rent, light, heat, power, and a limited amount of clerical help. All other expense such as long-distance telephone, advertising, additional office help beyond the amount allowed——

Mr. T. C. Townsend: That is going pretty far afield, it seems to me.

The Court: Sustained.

Mr. Lauritzen:

Q. Did you receive any salary?

A. I did not.

Q. And out of what you received as commission you had [fol. 3060] to pay certain expenses?

A. That's correct.

Q. You were running this more or less in a way as your own business? Am I correct in that?

A. Yes.

Mr. Ray: This has no pertinency to these issues. We object.

The Court: I sustain the objection.

Mr. Ray: I should think counsel would stop it.

The Court: I told counsel the only questions permitted here at present are questions qualifying this man as an expert, unless you ask questions that the Court feels are pertinent to the case factually.

Mr. Farmer: If the Court please, I don't like to butt in on this; but the debtor offered quite a number of witnesses whose experience had been along the same line as the man who is now on the witness stand.

Mr. T. C. Townsend: Who were those witnesses?

Mr. Farmer: Mr. Pulfer and Mr. Reed.

The Court: Mr. Pulfer was a member of the board of directors of the company and had a great deal to tell about the factual issues.

[fol. 3061] Mr. Farmer: And Mr. Reed was an honorary vice-president and he went around and——

Mr. Jaegerman: I think Mr. Palmer told Mr. Reed——

The Court: That doesn't have a thing in the world to do with whether this witness' testimony is pertinent or not.

Mr. Farmer: I was telling you why. They got up on the witness stand and expressed opinions about whether this company could be reorganized, and about the salability of these face amount——

The Court: I suppose this man will too if he is qualified.

Mr. Farmer: And they won't let Mr. Lauritzen qualify him. Here is a man whose experience has been such as it is, and he wants to tell about it, and Mr. Lauritzen has brought him here to testify about it.

The Court: It is too bad we can't satisfy you, Mr. Farmer. The Court can't let evidence in except as is indicated, so I will ask counsel to confine his examination to that line.

Mr. Lauritzen:

Q. Did you yourself personally train salesmen?

[fol. 3062] A. Yes, sir.

Q. In that training course, did you make them fully familiar with the Wisconsin law relating to Fidelity's operations?

A. Very definitely.

Mr. Ray: We object.

The Court: Sustained. Strike out the answer.

Mr. Lauritzen: *Q.* This may not be material as to qualifying this gentleman. Surely it is material in the representations that were made to Wisconsin contract holders of the manner in which the sales campaign was conducted.

The Court: It doesn't make any difference.

Mr. Lauritzen: What I asked him was whether he instructed his men in those particulars.

The Court: No. I sustain the objection.

Mr. Lauritzen:

Q. Did you advise them of the law?

Mr. Ray: We object.

The Court: I sustain the objection.

Mr. Ray: That wouldn't have a thing to do with it.

Mr. Lauritzen: As to whether the salesmen, when they were given their training course and told what they were to [fol. 3063] present to the public, were told that they were to present to the public the situation with respect to the operation of the laws of Wisconsin upon that contract?

The Court: I sustain the objection.

(Whereupon at 3:20 o'clock P. M. a recess was taken until 3:32 o'clock P. M.)

After Recess

Mr. Lauritzen:

Q. I believe you told us that your work with Fidelity was of recruiting, managing, and directing a sales force?

A. I did.

Q. How did you get your salesmen in Fidelity?

Mr. Ray: Your Honor, that is irrelevant. We don't care how he got them. I don't believe it makes a bit of difference.

The Court: Overruled.

A. I got them by personal contact, through bank contacts in the cities and villages throughout the State, and through newspaper advertising, in the want-ad columns in the newspaper.

Mr. Lauritzen:

Q. And did you become familiar with the difficulties and problems generally of recruiting salesmen for this type [fol. 3064] of operation?

A. Yes, sir.

Q. Did you become familiar with what the ratio would be as to the number of men you would have to interview to get one man?

Mr. Ray: If the Court please, that has been gone into several times. There is no issue about it. It is irrelevant.

The Court: Who was the other witness?

Mr. Ray: Carroll Evans.

Mr. Palmer: I understand this question is asked to show this man's qualifications in order to answer the hypotheti-

cal question later on, not the truth as to facts one way or the other.

The Court: That is the only reason why this is being admitted.

Mr. Palmer: The truth of the answer doesn't make any difference. It is a question to show his experience.

The Court: Overruled.

Mr. Lauritzen: Will you read the question.

(The question was read.)

A. By actual statistics——

[fol. 3065] The Court: He just asked you a question to be answered Yes or No.

A. Yes.

Mr. Lauritzen: Mr. Steussy, did you become familiar with the length of time and effort it took to train a particular salesman and to impress upon him the sales policies and practices of Fidelity?

A. Yes.

Mr. Ray: The same objection.

A. Yes.

The Court: Overruled.

Mr. Lauritzen:

Q. How long were you with Fidelity? From what time to what time?

Mr. T. W. Townsend: I believe he answered——

A. April 7th 1931 to the 31st of December 1940.

Mr. Lauritzen:

Q. And when you left Fidelity, where did you go?

A. Franklin Life Insurance Company, Springfield, Illinois.

Q. In what position?

A. Capacity of vice-president in charge of annuity sales.

Q. Will you tell us just what that meant, as to what your [fol. 3066] duties were.

A. My duties were stimulation in the recruiting of life insurance salesmen generally, and particularly in teaching them the annuity selling business.

Q. And are you still with the Franklin Life Insurance Company in that capacity?

A. I am.

Q. What particular type of contract sold by Franklin Life Insurance Company have you been concerned with in your work?

Mr. Huwe: I object.

The Court: Overruled.

A. The contract created last Fall to take the place of a contract that our agents were selling, issued by the Great American Underwriters in Texas, which was a face amount certificate. This contract was constructed as a life insurance policy with six premium years on a monthly payment basis, at the end of a certain waiting period creating a cash value for which a life annuity could be purchased at the time it matured, or get it thereafter with the interest computed at 3% annually after maturity.

Mr. Huwe: I move that the answer be stricken either [fol. 3067] qualifying him as an expert or with reference to this particular hearing.

The Court: Overruled.

Mr. Lauritzen: Mr. Steussy, was that a contract originated by Franklin?

A. Originated by Franklin when the Investment Act of 1940 rendered their Underwriter's certificate unsalable after the first of the year, because it didn't comply with that Act.

Q. Then do I understand that Franklin was selling what you term the "Underwriter's certificate" prior to January 1st 1941?

A. Franklin's agents were selling that certificate; that is right.

Q. And, Mr. Steussy, in how many states were they selling that certificate?

A. They were selling that certificate in Texas—the answer is five states.

Q. Now, with regard to the presnet contract with which you went with Franklin Life to promote the sale of, in how many states was that policy filed with the state authorities and offered for sale?

[fol. 3068] A. Qualified in eighteen states.

Q. Including the State of Wisconsin?

A. Correct.

Q. Mr. Steussy, when you went with Franklin in the capacity that you just related, I take it that you again engaged in the business of recruiting salesmen?

A. Correct.

Q. And in recruiting salesmen, did you take on any of those that had been with Fidelity?

Mr. Ray: That certainly is irrelevant.

The Court: What is the purpose of that, Mr. Lauritzen? Do you want to show that they have got them now and can't get them back?

Mr. Lauritzen: If the Court please, we want to show, your Honor, the experience of the same men who had sold for Fidelity under Mr. Steussy and their experience in selling under Mr. Steussy under this present contract that the Franklin Life Insurance Company is offering.

The Court: It is too remote. I sustain the objection.

Mr. Palmer: Some of the witnesses were testifying in great detail that the Franklin Life Insurance Company was selling contracts very similar to what any reorganized com- [fol. 3069] pany would sell and having no difficulty. I believe this would be pertinent and contradictory, if the Court will allow the statement of that witness——

The Court: That isn't the point. He is asking what Fidelity salesmen got.

Mr. Palmer; I presumed he was leading up to a comparison of their selling experience afterward and before, and this was really a qualifying question.

The Court: Let's go direct to what the experience is in selling this contract, and not complicate that with questions about former salesmen of Fidelity.

Mr. Lauritzen: All right, your Honor. Mr. Steussy, have your efforts in attempting to sell the new Franklin Life contract been comparable to those which you put forth in selling the Fidelity contracts?

Mr. Ray: We want to object, because there are so many differences between the new contract and the Fidelity contract.

The Court: Overruled.

A. We find the selling of the savings contract very difficult.

Mr. Lauritzen:

Q. What I mean by that, did you use the same type of [fol. 3070] sales effort and put the same amount of energy and time into it?

A. Very definitely, and employing the same men.

Q. Mr. Steussy, what success have you had in selling this Franklin contract?

A. Very disappointing.

Q. Will you elaborate on that a little bit?

A. When we first started out——

Mr. Ray: We object to that.

The Court: Overruled.

A. When we first started out, these men were naturally very happy to have a new connection, realizing that they had some income.

The Court: That doesn't make any difference. Just answer his question.

A. May I say that our sales volume in April, the fourth month, reached $300,000. By June, with the defense bond program competing very severely, it dropped to a hundred thousand. It has been below that since.

Mr. Lauritzen:

Q. Mr. Steussy, what is the size of the Franklin Insurance Company and how long has it been in business?

[fol. 3071] A. Fifty-seven years, and their resources are slightly in excess of forty-five million dollars.

Q. Mr. Steussy, can you give us the reason why your efforts to sell this Franklin contract have not been successful?

Mr. Ray: We object, your Honor.

The Court: Sustained.

Mr. Lauritzen:

Q. Mr. Steussy, can you tell us, did you have occasion to find out in your experience, as you have related it, what it costs to build a sales force comparable to that which you built for Fidelity in Wisconsin?

Mr. Ray: We object to that, your Honor.
The Court: Overruled.

A. I did.

Mr. Lauritzen:

Q. Mr. Steussy, if you were again to attempt to recuirt such a sales force, would those costs be greater or less than they were when you recruited them?
A. Four hundred per cent greater.

Mr. Huwe: Your Honor, I move the answer as well as the question be stricken. Here is a man who has recruited for from five to eighteen states, and to compare the figures of Wisconsin, one state, with five to eighteen where the law [fol. 3072] might be different, where there might not be any deposit, and therefore any attraction or argument on the salesmen's part, is not comparable. It is not a fair question.
The Court: The Court will make the proper comparison in view of those circumstances, so I will overrule the objection.

Mr. Lauritzen:

Q. Mr. Steussy, you had experience in determining how long salesmen would stay with an organization, such as those that you have been in charge of, have you not?
A. I did.

Mr. Ray: If that is relevant or material, it certainly has been gone into in this hearing. Mr. Evans and other witnesses on cross-examination have been asked about that over and over again. There doesn't seem to be much dispute about what the turnover is.
The Court: It is a qualifying question. I overrule the objection.
Mr. Lauritzen: Mr. Steussy, in your opinion, would you have a greater or less turnover in salesmen if you were now starting to recruit a sales force for Fidelity or some similar organization?
[fol. 3073] A. My experience is that it is greater.

Mr. Ray: Objection.
The Court: Overruled.
Mr. Lauritzen: I didn't hear that.

A. My experience is that it is greater.

Q. Can you tell us why that is true, Mr. Steussy?

Mr. Ray: Mr. Evans went into all these questions, your Honor.

Mr. Lauritzen: Mr. Ray, Mr. Evans wasn't my witness.

Mr. Ray: I don't care whose witness he was. He was put on the stand and testified to these facts, and they have not been disputed.

Mr. Lauritzen: I don't know what this witness' answer may be.

The Court: He is attempting to answer now a question which is based on the qualification that he has been shown, I am sure, to possess: The question, as I understand it, asks him to give his opinion. I will overrule the objection.

A. Chiefly because they cannot get into production as quick as they used to, because the market isn't there for a saving certificate.

[fol. 3074] Mr. Lauritzen:

Q. And why is that?

A. Due to the fact that the costs of living are high, out of proportion with earnings, and the defense bond is keenly felt—sale of the defense bond.

Q. Can you tell us whether or not the sale of installment Building and Loan Association stock on the installment plan has any thing to do with that situation?

A. They dropped there because of the insurance, very definitely and yet their sales show a drop in the last six months due to the fact that the market has changed.

Q. You mean because they are insured by Federal insurance?

A. By an agency of the Federal Government. That is right.

The Court: Mr. Steussy, do you find the same situation applied to the sale of life insurance contracts?

A. The so-called savings side of the life insurance contracts. In other words, the sales of annuity endowments, high premium life insurance is now at a new low, and the low premium life insurence is constantly offsetting that volume loss the other way. In other words, the men who must pay, as they anticipate, increased taxes this year,

[fol. 3075] must immediately establish for their families additional resources in the event of death to offset losses of that kind, which they must pay out; hence, it has stimulated the sale of the so-called low premium insurance, and it has curtailed the sale of so-called high premium insurance. That is universally and nationally our picture, here and in Canada both.

Mr. Lauritzen:

Q. Do you know of any life insurance company that is presently making a success of selling its savings type of annuity policies or contracts?

A. They are all finding the same report that I have just given on our situation—those with whom I am familiar—and I believe I know the entire setup.

Q. By reason of this situation existing, what action has your firm taken with respect to the cessation of efforts to sell this particular contract, or either to drop it or to make increased efforts to put it across?

Mr. Ray: We object your Honor.

The Court: Sustained.

Mr. Lauritzen: Mr. Steussy, in your work, have you become familiar with the fact that oftentimes one life insurance company takes over or reinsures various types of [fol. 3076] policies or contracts issued by other life insurance companies?

A. I have.

Q. And in your experience, under what circumstances will it be desirable for a life insurance company to take over or reinsure such other policies or contracts?

Mr. Ray: Your Honor, the vast subject of reinsurance has no place in this hearing.

The Court: I sustain the objection.

Mr. Ray: We can talk a week just on that.

Mr. Lauritzen: If the Court please, there has been an overwhelming, a voluminous amount of testimony here as to the fact that various officers and people in Fidelity felt and still feel that a life insurance company might be able to take Fidelity over. Now, I think Mr. Steussy has amply qualified himself to state what the facts are which would lead to a life insurance company doing such a thing.

The Court: That doesn't have anything to do with reinsurance.

Mr. Lauritzen: Let me strike the term "reinsurance." What I mean is taking over and continuing the business of [fol. 3077] another company selling such a contract as Fidelity's, or some other form of saving plan.

Mr. Ray: You didn't ask him if he had any experience along that line——

Mr. Lauritzen: I now amend that, Mr. Ray.

Q. Would you like the question read?

A. As it is amended.

(The question was read as amended.)

The Court: He asked this witness if he had had any such experience as that.

Mr. Lauritzen: Whether he had any experience which would enable him to tell us under what circumstances a life insurance company would find it desirable to take over a company issuing such contracts. Have you had any such experience, Mr. Steussy?

The Court: I think I would have to sustain the objection to the question in that form. You are leaving it to the witness, whether he has experience that will enable him to tell that or not. If what you are doing is to find out what experience he has had, then we will see whether that qualifies him.

Mr. Lauritzen:

Q. Mr. Steussy, in your connection with the Franklin [fol. 3078] Life Insurance Company, have you had experience with that company considering various propositions made to them to take over companies selling face amount certificates or some comparable contract?

The Court: That won't do.

Mr. Lauritzen:

Q. What experience have you had with respect to your company's having analyzed the prospects and determining for itself the desirability of taking over a company selling face amount certificates?

The Court: I will admit that question if the witness has had experience in the actual taking over and operation;

you may bring that out and then that will qualify him by what his company is considering to do; otherwise I don't think it will qualify him.

Mr. Lauritzen: He is permitted to testify as to what facts and circumstances must exist for a company to undertake taking over such a company, if he can answer my next question.

The Court: I have ruled on that.

Mr. Lauritzen:

Q. Has the Franklin Life Insurance Company taken over any companies selling annuity policies?

Mr. Ray: We object to that because annuity policies are insurance policies, and it may have reinsured insurance [fol. 3079] policies. That isn't taking over a face amount certificate company.

The Court: What kind of annuities do you mean?

Mr. Lauritzen: Annuity contracts based on a savings feature of placing installment payments with a concern for the purpose of accumulating a sum of money; in other words, on the savings side of a life insurance annuity policy.

The Court: Without life insurance as a part of them?

Mr. Lauritzen: Or with life insurance as a part of them.

Mr. Ray: You cannot have an annuity without insurance, as I understand it.

The Court: If you divorce it from insurance I will permit the answer.

Mr. Lauritzen: When Fidelity sold its series B, which was, in effect, an annuity coupled with insurance——

The Court: It wasn't life insurance. It was insurance that would pay out the face amount of the certificate.

Mr. Lauritzen: But it was life insurance on the life of the contract holder?

The Court: Life insurance to that extent.

Mr. Lauritzen: Well, now, let me clarify that, will you, [fol. 3080] Mr. Steussy.

Q. Will you explain for us, if you can, the similarity or differences in the contract which Franklin Life Insurance Company has been attempting to sell, with the contract which Fidelity sold having the insurance feature.

A. The contract Franklin is now selling is an improved face amount certificate taken over from the Great American Underwriters and since that qualifies as an insurance policy, the face amount certificate was reconstructed just as the Fidelity contract would have to be reconstructed if the Fidelity Assurance Association was going to operate as an insurance corporation—briefly, that is it.

Q. Was that Great American Underwriters contract a contract similar to Fidelity's?

A. So much alike that they were almost like twins.

Q. Now, can you tell us, was that the same contract that has proved successful with your firm? Is that not correct?

A. That contract was sold up to the close of last year.

Q. And now that contract business has been taken over by Franklin?

[fol. 3081] A. And the same sales people are selling it in the new form.

Q. Yes. And in that new form, you haven't been able to sell it, as I understand you?

A. Last December they sold a million dollars' worth of face amount certificates, a little over a million and forty-odd thousand of the Great American certificate, and their January sales were two hundred thousand; at the end of April we reached three hundred thousand face amount, and since then it has been going down.

Q. And is it your opinion that it will continue to go down?

A. It will always sell, because it is in the rate book. Life insurance companies put everything in their rate book. It is part of their line, part of the "57 varieties." Salesmen here and there will find a good need for that type of form.

Q. But you believe that the demand and sale of such a policy is decreasing at the present?

A. Materially.

The Court: Mr. Steussy, does the salability of a contract of this kind depend largely on the vigor with which [fol. 3082] the salesman pushes it, as against other forms of contracts or policies?

A. I would like to answer that by saying this to you, that the unfortunate thing of a life insurance man talking to the prospective buyer about a savings account is this: Let us say he is going to save $150 a year, twelve and a

half dollars a month, and he only gets a thousand dollars of life coverage in this so-called certificate. For that same $150 he can get a low premium life insurance policy and get his family ten or twelve thousand dollars of protection. That is the stumbling block of tying up a so-called monthly savings program with a life insurance policy, and that has definitely been the experience of the Great American certificate and the Franklin plan in trying to sell it as——

The Court: What I am trying to find out is, if there is a definite connection between the salability of one of these savings plans and the vigor with which the salesmen push it, as distinguished between it and some other plan.

A. Of course, it's needless to say that a man, if he is excited about something, enthusiastic, can do a better job of selling, but believe me when I say to you, we tried [fol. 3083] exactly the same methods and just couldn't get that enthusiasm up to where it did the trick.

Mr. Lauritzen: I think I might clarify that.

Q. Did you not, in effect, in your connection with Franklin, set up what we might term, in the Franklin Life Insurance Company, a separate division with respect to the activity and force used in sales and placing that force and activity entirely behind this annuity type contract which you testified they had created?

Mr. Ray: Your Honor, I don't see how that could be material.

The Court: Overruled.

A. We very definitely had special training classes and gave special training to a special group of men who, to all intents and purposes, specialized in that matter.

Mr. Lauritzen:

Q. Were a great number of those men the men who had been at the top in selling for Fidelity under your supervision?

A. That's correct.

Q. Now, after the S. E. C. investigation in 1938, it became very difficult to sell the Fidelity contract, is that right?

A. That's also correct.

[fol. 3084] Q. Were there some of your men in Fidelity who were nevertheless able to sell Fidelity contracts at all times after this S. E. C. investigation?

A. I was able to retain out of 225 that I had under license in 1938 thirty-seven for 1939.

Q. And did a number of those men sell Fidelity under those circumstances——

Mr. Ray: I object.

The Court: Sustained. I thought the Court made it plain, since there is no controversy as to the particular fact that you are asking about now, that there is no use putting and duplicating the questions on the record. This witness was qualified to give his opinion as an expert. The Court will permit him to give his opinion as an expert. but not give cumulative testimony of what has already been gone into.

Mr. Lauritzen: I think my next question will clarify it. Of the salesmen that you took into the Franklin setup from Fidelity, were those the salesmen who had, after the S. E. C. investigation, been able to continue and still make a living selling the Fidelity contract?

Mr. Ray: Objection.

[fol. 3085] The Court: Overruled.

A. Only those salesmen that were able to carry on and keep themselves above water, so to speak, were the ones that I took in.

Mr. Lauritzen:

Q. What has been the experience of those men?

A. I took twelve men with me from Wisconsin, and I have one of them left.

Q. And what happened to the eleven?

A. They have passed out of the picture.

Q. And why?

A. They were unable to sell a sufficient volume to stay in the business.

Q. In addition to those twelve men, did Franklin take on some other Fidelity men in various places in the country in which Fidelity or Franklin was selling?

A. About a half dozen in Michigan, eight in Ohio, about six in Illinois, a dozen in Missouri and Kansas combined, and we sent some from those states into other states.

Q. And what has their experience been?

A. There are now a total of five of them left.

Q. Was the American—can you give me the name again?

[fol. 3086] A. Great American Underwriters.

Q. Was the Great American Underwriters the only type of face amount certificate company that Franklin ever took over?

A. That's correct.

Q. Have they considered taking over others?

Mr. Ray: Your Honor, I object.

The Court: Sustained. Mr. Steussy, do you know what these salesmen of Fidelity other than the five you still have working for you are doing?

A. Yes; I know what a great many of them are doing.

Q. Are they working along the same line as they formerly did, as salesmen?

A. No. That would be about fifty-fifty.

Q. You mean fifty per cent are still engaged in some form of salesmenship similar to that which they did before?

A. They are selling tangibles.

Q. The other fifty per cent—are they employed at anything, as far as you know?

A. I know of one men who has gone into Y. M. C. A. work. Another man has gone into a manufacturing plant. I know of another man who has gone into another manu-

[fol. 3087] facturing plant; another who has gone into the mortgage and real estate business; another who has gone into the stock selling business.

Q. By selling "tangibles" do you mean something other than an investment, whether a life insurance or new contracts or stocks and bonds, anything of that sort?

A. I mean goods of various industries—sash and doors, building supplies, iceboxes, automobiles, and so on.

Q. When a company has a large number of contract holders such as Fidelity did, and sold a large number of contracts, may it under some circumstances be desirable for another organization to take that organization over and continue it in business?

A. Very definitely.

Q. Now, with respect to your knowledge of Fidelity's affairs, do you believe it would be advantageous for any organization to take over Fidelity in that manner?

A. Very definitely not.

Q. Will you amplify that?

A. It has lost that which a company taking it over is after—the sales organization. It has disappeared, disassembled and disintegrated.

[fol. 3088] The Court: I thought you meant, when you said it would not be advantageous to take it over, that it would not be advantageous to the holders of contracts in that company.

A. Oh, no.

The Court: I judge from your answer you mean it would not be advantageous to the outside company.

A. The company taking it over—that's right.

Mr. Lauritzen: With respect to contract holders of Fidelity, do you believe it would or would not be advantageous to them to have Fidelity taken over by another organization and continued in business?

Mr. Ray: We object to that, your Honor.

The Court: Overruled.

A. I would say that it would be a disadvantage to them.

Mr. Lauritzen:

Q. Will you amplify that?

Mr. Ray: I don't like that word "amplify." I want to know why he makes that statement.

Mr. Lauritzen:

Q. Will you give the basis for your statement?

A. The basis for my statement is this: Anybody that takes it over must make some money in order to continue to take it over, and that would be transferring equities [fol. 3089] into a new kind of paper which would mean a new load, because of the fact that the very same purchaser would have to pay in more money—when he found it would be better to take a loss, keep what he already has, instead of paying in, take another loss and make it a disappointment later on.

The Court: You seem to base your answer on a very fanciful fabric of your own mind which was not in the question. Do you have any ideas independent of this imaginary fabric that you have built up?

A. Will you ask me a direct question?

The Court: I ask you—will you read the question.

(The question of the Court was read.)

A. Your Honor, of course I have talked to a great many thousands of Wisconsin contract holders since 1938. I was born and raised in the State. I know a great many of them personally. I know their ways. I know their methods—their way of living, and I believe that I can say to you very definitely that what I said wasn't something that I haven't thought about a great deal. I believe that my statement wasn't at all fanciful. I think it is the truth and very evident, so far as my Wisconsin people are concerned. [fol. 3090] The Court: Now, you said it would be a disadvantage if some structure were formed and transfer made to a new company, that it would take money from the equities of contract holders and create some new form of obligation. It would give them less than what they now have. Of course that is quite apparent without your answering. If the question and answer are going to be of any benefit to the Court, you have got to base it on something different from that. You have to base it on the assumption that there will not be taken anything from the equity of the contract holders or given to anybody at all. If you have any answer based on that assumption, the Court will be glad to hear it.

A. I can say this too, that the sales people that I tried to adopt—or adapt to the new operation—that we had to adapt ourselves to—where does a salesman logically go but back to his old customers to get new names, and I often find that the people who are now so-called delinquent have found a new outlet for that money, have made new commitments, and in most cases would be unable to again reinstate themselves and continue payments as they are now making. They could, of course, get the benefit of what a paid-up contract would do for them if a firm rate of interest [fol. 3091] would prevail.

Mr. Lauritzen:

Q. Mr. Steussy, in your answer, you mentioned a company taking them over and paying a new loading charge. Is that based on some experience that you have had with respect to contract holders surrendering policies in——

The Court: I sustained the objection and will ask counsel to base no questions on any assumption that there will be any equity taken from anybody that has equities.

Mr. Lauritzen: I don't mean to base my question on any such assumption, but what I am getting at is this: Let us say, Mr. Steussy, that Mr. Jones, a contract holder in Wisconsin or elsewhere, has a par cash surrender value of a thousand dollars, and that if the rights which were attempted to be secured to him under the Wisconsin laws were left unimpaired and he got that thousand dollars, what is your answer with respect to the desirability of that man going into an organization either taking over or created out of Fidelity.

The Court: Well, the Court knows about as much about that as this witness could. I sustain the objection.

Mr. Lauritzen: Mr. Steussy, in selling Fidelity's con-
[fol. 3092] tracts in Wisconsin, was it a factor of assistance in the sales organization that there is in existence in Wisconsin certain laws relating to Fidelity?

Mr. Ray: We object to that, your Honor.

The Court: Sustained.

Mr. Lauritzen: If the Court please, I think this would bear directly on Mr. Steussy's testimony that if you have no such factor, as to whether or not it would be more difficult to sell another type of contract or whether that difficulty might be overcome in some manner.

The Court: The question clearly calls for an opinion of the witness, and the Court is just as well advised before as after as to whether that law would have been a factor.

Mr. Lauritzen: If the Court please, I asked him in his actual experience as head of this sales organization, what effect, beneficial or otherwise, on the ease of selling that factor has—not his opinion but what his experience was as head of this sales force.

The Court: Now you are changing your question. Read the question, please.

(The question was read.)

[fol. 3093] The Court: I sustain the objection.

Mr. Lauritzen:

Q. Let me ask you this, Mr. Steussy. Was that law of aid to Fidelity's force in Wisconsin?

Mr. Ray: Your Honor, that is the same question.

Mr. Lauritzen: I don't think so. The Court just explained the distinction. Now, let us say——

The Court: You say, "Was that law of aid?"

Mr. Ray: And the other was, "Was it a factor of assistance."

The Court: I don't see any distinction.

Mr. Lauritzen: In the Court's previous ruling the Court ruled——

The Court: I sustain the objection.

Mr. Ray: We objected because it isn't material.

Mr. Lauritzen: I believe that is about as material a thing as we could possibly have, both as regard to Wisconsin contract holders, whether they are going to get under way with a type of operation similar to this in the future——

The Court: I sustained the objection. If you have a law out there in which the present holders are protected 110%, then that law will be just as effective, whether it was of assistantce in selling a contract or not; so I don't see [fol. 3094] that it is at all material.

Mr. Lauritzen: Just this, if the Court please: If they were attempting to sell some sort of insurance contract which would become subject to the Wisconsin insurance laws, this law would no longer be a factor at all. They would be operating, under those circumstances, under an entirely different part of the law, and any assistance that might have been given them in the past, in being able to quote this law, would not be in existence under the new situation.

Mr. Ray: Certainly if this contract which the Franklin is selling is so different, then the same Wisconsin law cannot apply. I got the idea from the witness' discussion that it was quite different. Now the attorney from Wisconsin tells the Court that it is so different that it is not even restricted by the same statutes in Wisconsin.

Mr. Lauritzen: Only for the purpose of illustrating and forming a basis for Mr. Steussy's previous opinion as to the difficulty that you now have in getting under way with any savings plan, if you couldn't have the benefit of such a law.

The Court: Let's go ahead. The court has ruled.

[fol. 3095] Mr. Lauritzen:

Q. To your knowledge, Mr. Steussy, did the Banking Commission of Wisconsin at one time become concerned for the safety of Wisconsin contract holders of Fidelity?

Mr. Ray: We object.
The Court: Sustained.

Mr. Lauritzen:

Q. Mr. Steussy, did Fidelity have negotiations in which you took a part with the Banking Commission of Wisconsin relative to ascertaining the safety that was being provided for Fidelity holders in Wisconsin, and what their rights were?

Mr. Ray: We object to that, your Honor. That is not relevant to the issues here.
The Court: Sustained.
Mr. Lauritzen: If the Court please, just this: There has been a great deal of testimony and discussion in this case to the effect that these deposit laws—whether it was on a total contract liability basis in the various states; and in that connection, I desire to bring out through Mr. Steussy the direct representations that were made by Fidelity through its counsel and officers to the State authorities of Wisconsin, as to defining the rights of those contract holders, which rights will ultimately have to be decided [fol. 3096] in this proceeding, both as to whether there can be a reorganization, and if there is a reorganization, as to what their rights will be. I think that is a subject that we have gone into at considerable length here during this hearing.
Mr. Ray: That subject isn't pertinent to the matters which the Court must decide, and what has been gone into has been brought into the case by cross-examination of Mr. Lauritzen over our objections, and why should he now bring a witness in to testify to matters which are now immaterial which he has himself brought into the record?
The Court: You don't think that is material now?
Mr. Lauritzen: Definitely, your Honor.
The Court: I mean on the question of good faith.
Mr. Lauritzen: On the question of feasibility of the thing—just this: If the Wisconsin law is valid, both as written and as administered; and if the terms of the contract which, by reason of that law, and the contract of Fidelity and representations made to contract holders—that that trust deposit out there is entirely valid under the representations that Fidelity made, then it will have a great effect in determining whether there can be a re-

[fol. 3097] organization, because that would remove the possibility of the reducing, over the objection of any of those contract holders, of those equities and would make more difficult the search for additional capital, which apparently and without question must be found somewhere, if Fidelity were to continue both to comply with the present state laws which are not abrogated and with the Investment Company Act of 1940, which is on a plain arithmetical basis. I think that is of the essence in this proceeding in determining the feasibility of any plan which might be proposed or determined, whether any possible plan could be proposed.

The Court: It is your contention that the status of the deposit in Wisconsin is to be determined by negotiations between Fidelity and the officers of Wisconsin rather than by the law of Wisconsin?

Mr. Lauritzen: I would say, your Honor, that if there were any room for doubt in the construction of the law, that the practical application of it, as between the authorities in charge of administering that law and the officers of Fidelity in setting up a deposit for the benefit of the contract holders would be very material.

The Court: I sustain the objection.

[fol. 3098] Mr. Lauritzen: Mr. Steussy, do you recognize this document which I show you?

A. Yes, sir. (Examining document.)

Q. Will you tell us what it is.

A. It is a part of the sales kit that we used in the sale of the contract, in the sale in Wisconsin.

Mr. Ray: I can't see that anything in the sales kit in selling contracts in Wisconsin is relevant to the issues before the Court.

Mr. Lauritzen: It has already been ruled, and there is evidence in the record here, as to representations made in other states, and surely these representations must be of equal value as those.

The Court: I will overrule the objection.

Exhibit 106

The paper referred to was marked for identification, at the request of Mr. Lauritzen, as above indicated.

Mr. Lauritzen: We offer in evidence Exhibit 106.

Exhibit 106

The paper referred to, having been previously marked as above indicated, was admitted in evidence. The same is attached hereto as a part hereof.

[fol. 3099] Mr. Lauritzen:

Q. Mr. Steussy, are you a stockholder in Fidelity Assurance Association?

A. Yes, sir.

Q. And how much stock do you hold?

A. Ten shares of common and five shares of preferred.

Q. Can you tell us what you paid for it?

Mr. Ray: We object, your Honor.

The Court: Sustained.

Mr. Lauritzen: I think, if your Honor please, this would show the interest of Mr. Steussy and would provide a criterion for the Court in determining the value of his testimony.

The Court: What difference does it make if we know what he paid for it if we know it isn't worth anything?

Mr. Lauritzen:

Q. May I ask, did you pay money for it?

A. I did.

Q. How long ago did you get it?

A. 1932, I purchased the common and the preferred I got as a dividend.

Q. I didn't hear that.

A. Purchased the common in 1932 and the preferred I got as a dividend later on, and I kept it.

[fol. 3100] Q. Mr. Steussy, Fidelity sold various contracts of various types—am I correct in that?

A. That is right.

Q. When Fidelity came out with a new series of contracts, what instructions did you receive from the home office of Fidelity as to contacting previous contract holders with respect to the purchase of a new contract?

Mr. Ray: Your Honor, I object to the question. I can't see how that would be relevant to the issue of jurisdiction——

Mr. Lauritzen: Just this, your Honor: If it is shown that by numerous switches of contract holders from one

contract into another, it provided a basis for giving a salesman something to sell, and provided a man a livelihood and kept him on with the compnay, and further, was a source of profit to the company, the availability of such inducements to salesmen and such inducements to the company in the future would have a great bearing on prospective earnings of income.

The Court: It is too remote. I sustain the objection.

Mr. Lauritzen:

Q. Mr. Steussy, from your experience, can you tell us how much you estimated it would cost in dollars to develop [fol. 3101] a sales force for a company comparable to Fidelity, a sales force comparable to that which you had in Wisconsin?

Mr. Ray: We object. In the first place, when he uses the words "How much it would cost," the costs of developing a sales force do not all fall—in the past did not all fall upon the company.

Mr. Lauritzen: I realize that fully, Mr. Ray.

Mr. Ray: If you had some way of getting at the net cost to the company, it might mean something.

Mr. Lauritzen: That is what I mean to ask him.

The Court: It seems to me when you are attempting to confine it to the State of Wisconsin that you are very much too localized to be of any assistance to the Court. I sustain the objection to that question.

Mr. Lauritzen: I think that's all for the present, Mr. Steussy.

Mr. Palmer: May I have permission to examine the witness on one phase?

Mr. Ray: What is that?

Mr. Palmer: I understood the witness to say he did not think Fidelity could be reorganized in any way and should [fol. 3102] be liquidated.

Mr. Ray: I didn't understand him to say that.

The Court: Yes, I think he did testify to that effect. Go ahead.

Mr. Palmer:

Q. Mr. Steussy, if the Court will permit me, after you became a salesman in Wisconsin or any place else, did you study selling methods?

Mr. Lauritzen: Excuse me, Mr. Palmer. I think you should say, manager of the sales force, because I understand Mr. Steussy was not a direct salesman.

Mr. Palmer:

Q. After you became a sales manager, did you study selling methods?

A. Very definitely.

Mr. Ray: I object to that.

The Court: I don't think we ought to go into the qualifying questions again. Let's get to the heart of anything new.

Mr. Palmer: I wanted to broaden, if possible, his qualifications for the basis of later questions.

The Court: Well, he has already qualified along that line.

Mr. Palmer: I wanted to get what studies he had made; [fol. 3103] in other words, the basis of his——

Mr. Jaegerman: Is Mr. Palmer challenging his qualifications?

Mr. Palmer: No, your Honor. They were given very generally, and I wanted to broaden the qualifications if I can broaden them. In other words, as I understand it, the weight of any expert witness' testimony, the weight which the jury or the Court gives to the witness' testimony depends to a large extent upon the qualifications which he exhibits to that body.

The Court: All right. Without any further argument, go ahead.

Mr. Palmer:

Q. Now, in studying selling methods, did you read books on the subject?

A. A good many volumes. I wrote some—taught salesmanship; been a salesman all my life.

Q. Where were you teaching salesmanship?

A. In a certain small school in Milwaukee—as something to do.

Q. Have you since that time studied insurance?

A. Studied insurance way back in the twenties; studied it all the time as I went along.

[fol. 3104] Q. Did you study face amount securities so you would know the difference between one type and another?

A. I believe I have every type of certificate that has

ever been construed or thought of or sold on record in a file and available.

Q. Have you made a study of them?

A. Very definitely.

Q. Have you made a study of various types of insurance policies?

A. I have bought a good many thousands of dollars' worth of them during my time, and when reverses come, you get delinquent and buy some more. I have certainly studied every branch of life insurance from the corporate sinking fund type to the benefit of the trust fund, which is created by means of insurance purchases, of course.

Q. Now, have you since your employment with the Franklin Insurance Company discussed with other officials of that company the various types of policies which they sell?

A. Very definitely.

Mr. Ray: He is getting into the Franklin Life Insurance Company, which has no relevancy here.

Mr. Palmer: I am getting to it.

Mr. Ray: That is about a fact having to do with another [fol. 3105] company——

The Court: I overrule the objection. See what it leads to.

A. We have regular conferences and intercompany study and meetings on the different types of instruments that we sell, very obviously, and have district sales meetings. Those are all discussed minutely.

Mr. Palmer:

Q. Do you have outside experts in the insurance field come and lecture and discuss insurance problems with you?

Mr. Huwe: I object. He is doing what Mr. Lauritzen was unable to do, trying to show that they have conferences and consider small insurance companies for reinsurance and all that sort of thing.

The Court: I don't so understand the purpose of his question. He is just trying to find out how much experience this man has in the field in which he operates.

Mr. Huwe: I suggest we get right down to the opinion question, and then if he isn't qualified, I think that is the best way to do it.

The Court: Overruled.

Mr. Palmer: Will you read the question.

(The question was read.)

[fol. 3106] A. We subscribe to, I suppose, all the important services, of which there are many, as you know. We are obviously members of the Life Insurance Company Convention, which Mr. Johnson is president of. We have naturally the benefit of everything available.

Q. Do you read those various journals published on the problems of insurance?

A. That is the reason why I own these glasses. I ruined my eyes doing it.

Mr. Huwe: I object to that answer and move it be stricken.

The Court: Overruled.

Mr. Palmer:

Q. Have you studied the reports made by the S.E.C. to the T.N.E.C. in pursuance to the Act of Congress? Have you read them?

A. I have read them but never studied them.

Q. Have you attempted to familiarize yourself with state laws in various states in which companies operate?

A. Will you state that question again?

Mr. Palmer: Will you read the question.

(The question was read.)

A. To a limited extent.

[fol. 3107] Q. Now, have you familiarized yourself to any extent or been advised as to the financial condition at present of Fidelity?

A. I believe that I have the information right up to date.

Mr. T. C. Townsend: I didn't get that.

Witness: I have the information right up to date.

Mr. Palmer:

Q. Do you know whether that information is that the general fund is approximately two and one-half million dollars or slightly more in the hole?

A. I believe that is about the figure.

Q. And does your information include the fact, if such it be, that Fidelity, with all of its assets against all of its liabilities, is about ten per cent under water, as it is called?

A. You mean by putting it all into one fund?

Q. Yes.

A. I didn't look at it from the per cent standpoint particularly.

Q. Will you take that as an assumption upon which I may base future questions. Were you also advised that the later series of contracts, A, B, and D, were nearly [fol. 3108] solvent, whereas the early series special annuity and special endowment had their reserve impaired to a far greater extent?

A. That's right.

Q. With those facts in mind, are you prepared to give the Court answers as to your opinion, based upon your experience and background, as to the possibilities or impossibilities of Fidelity being reorganized, or whether it should be entirely liquidated?

Mr. Townsend: I object.

The Court: Overruled.

Mr. Palmer: Will you read the question, please.

(The question was read.)

A. I wish you would read the question again.

(The question was reread.)

A. I will be very glad to answer those questions.

Q. Do you feel prepared and capable of giving answers to them?

A. I do.

Q. Now, keeping in mind the facts of Fidelity which you and I have discussed, so that your opinion with reference to Fidelity is based upon those facts, what have you to say as to whether or not Fidelity can be reorganized into a face amount securities company?

[fol. 3109] Mr. Hume: I object.

Mr. Palmer: All right. I mean a company selling face amount certificates.

Mr. Hume: This man is not qualified to answer that question, because he doesn't have any idea of finances, the

actuarial features of a business, and is merely qualifying as an expert salesman. He was working, up to 1940, as manager of sales in Wisconsin, and in this short period of nine months, even though he says he read thoroughly the T. N. E. C. reports on insurance companies, and listens to lectures; I say, he is not qualified to answer that question just on the experience that he has related.

The Court: Overruled.

A. The company cannot be reorganized with the loading cost permitted by the 7 per cent of the sum of money paid in by the depositor, or possibly load the contracts so that it can assemble a sales force and be successful in the selling of it.

Mr. Palmer:

Q. Are you basing that upon your experience first with Fidelity and your later experience with Franklin?

A. I am basing it on my experience in following the savings deposit certificates qualified with the S. E. C.

[fols. 3110-3119] Q. My next question is this. It is your further opinion, I gather from what you have told us, that Fidelity cannot be reorganized into a company which would sell a policy or certificate or contract similar to the one that Franklin Life Insurance is selling?

A. A salesman cannot sell one contract with a life insurance company, nor can a life insurance company sell one contract and be in the life insurance business.

Q. So that your answer to my question would be that a company could not be formed from Fidelity which would sell a policy or contract exactly similar to the Franklin policy?

A. The company could not be qualified with an insurance department in most states of this Union.

Q. I want your own opinion as a practical matter whether that company could work and exist.

A. Absolutely not.

* * * * * * *

[fols. 3120-3140] Mr. T. C. Townsend: Your Honor, the trustee has completed the first installment of its report, and has six copies: one for its office file, one for the Court, two for the S. E. C., and two additional ones. This can

be filed with the Court now or it can be filed with the Court tomorrow morning.

The Court: I suggest you just wait until tomorrow morning.

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[fols. 3141-3150] Cross-examination

By Mr. Huwe:

Q. As I take it, Mr. Steussy, you are holding yourself out as an expert with reference to both face amount certificate companies and with reference to insurance companies, as to the buyer's point of view, as to the seller's point of view, as to the financier's point of view, and as to the management's point of view, with the exception of the actuarial feature of the management?

A. That is exactly what I desire you to understand.

Q. That is the impression you desire to make?

A. That's correct.

• • • • • • •

[fol. 3151] Q. Then you emphasize the factor of rebuilding a sales force. That is the chief reason, you say, that a company like Fidelity could not re-enter successfully under the 1940 Investment Company Act?

A. I didn't say that was the chief reason. It is one of the paramount reasons.

The Court: What is another?

A. Another is that you have to qualify in the different states, which is expensive.

The Court: Doesn't any other company have to do that?

A. Most of them that are in existence are qualified. There are many states that I know of, for instance, if new companies of life insurance wanted to get in, they say, "We have plenty of them now."

The Court: We are talking about companies that qualify under the 1940 Investment Security Act.

A. From my study and observation, I would say to you that it is very remote.

The Court: I don't understand what you are talking about. I want to know what other element there is other than the difficulty of creating a sales force that would pre-

[fol. 3152] vent Fidelity from going ahead as an investment certificate company?

A. Consumer acceptance.

The Court: What is that?

A. Consumer acceptance, purchaser acceptance of the idea of such a plan.

Mr. Palmer: Is the Court assuming that Fidelity could qualify under the Investment Company Act?

The Court: I want the witness to tell me, if he can, what are the reasons why a reorganized Fidelity couldn't go ahead and sell face amount certificates as any other company could.

Mr. Palmer: Is the Court assuming by that question that the company could qualify under the Investment Company Act and asking the witness to dismiss that from his mind, or is the Court——

The Court: Certainly I am including that it could qualify. That's what I want to know. He says one reason why it couldn't is because it would take a lot of money to create a sales force. I want to know if there are any other reasons. Now, you say public acceptance or non-acceptance, but that applies equally to all companies.

A. I am afraid it doesn't, for the simple reason that the [fol. 3153] hundreds of thousands of lines of publicity that Fidelity has had, obviously it cannot live down unless the element of time continues to irradicate it.

The Court: Your next element is unfavorable publicity in the past?

A. That's right.

Q. Let's see if there are any others.

A. Unfavorable whispering campaigns among those who benefitted by the fact that the Fidelity sales activities became extinct.

Q. I don't know whether I understand that or not.

A. May I tell you off the record what I mean?

Q. Tell me on the record.

A. Let us assume that the company sold in a given area $600,000 of maturity fund face certificates per month, which would be in the neighborhood of seven million dollars a year. It takes those active, aggressive, highly specialized salesmen out of the field, and in that same area other—now qualified under the Investment Act of 1940—face amount certificate companies are operating. They have taken your

customers away from you; they have started them on a new certificate, where they cease paying on the other, and so on. That is what I am attempting to have the Court under-[fol. 3154] stand.

The Court: Go ahead, Mr. Huwe.

Mr. Huwe:

Q. So that there are successful face amount certificate companies operating now, taking customers away from Fidelity?

Mr. Palmer: I object to that, your Honor. The witness used that as an example and not as a statement of fact at all. Mr. Huwe should have so understood it.

Mr. Huwe: If he can't use a true statement of fact, what good is his example?

The Court: I overrule the objection.

Mr. Huwe: Now, Mr. Steussy——

The Court: Read the question.

(The question was read.)

A. There are very few operating, and they are not taking anything away from anybody. They are merely, in many cases, I am sure, where the people have discontinued their monthly installments because of publicity, court proceedings, and so forth, if they have money to save, it creates a field and they are going into other methods, rather than discontinuing savings—one of them being Government defense bonds.

Mr. Huwe:

Q. How long has this Government bond been on sale? [fol. 3155] A. I believe you are familiar with that.

Q. Well, let's have it in the record. You are an expert on these things.

A. Well, the present defense bond, as you know, is created out of and in no wise existed except by series numbers out of the original so-called savings bond. That change, as you know, took place late last year and finally got on sale this year.

Q. Now, do you know how many people are still paying to this day on their Fidelity contract? Do you know how many and the amount?

A. I know how many, if the information I received yesterday is correct.

Q. Do you know the amount?

A. I do not know the amount.

Q. Did you know the amount in September, August, and July?

A. No, sir. I can merely tell you what I was told it was presently receiving monthly on the protected contracts.

The Court: One question, Mr. Steussy. How long have those defense bonds of the Government been sold?

[fol. 3156] A. As defense bonds?

The Court: As savings prior to the change in the name?

A. Well, they came out, I would say, about 1937 or somewhere back there. I think Mr. Jaegerman can tell you exactly. I was very busy with the other selling.

Q. Fidelity had its peak sales after those bonds went on the market?

A. Savings bonds?

Q. Yes.

A. Certainly.

Q. You say there is no difference in defense bonds and the savings plan?

A. Only in face amount, and in some, only in yield, but we are in a different time again. In other words—discussing with you what I have said to one of the gentlemen in the room—the originality of the fact that the Government went into a monthly or a periodic savings plan—the inception of it was beneficial to Fidelity, beneficial to the syndicate, because it indicated that the Government was approving and rather encouraging an orderly program of thrift. Then they turn around and take your program and build it up where the cry is to the point where you get your [fol. 3157] change in grocery stores in stamps.

Q. Did it have the same advantages of the Fidelity plan then as it has now?

A. You mean from an actual, mathematical and actuarial standpoint?

Q. From every standpoint.

A. The answer would be No, from every standpoint.

Q. In what standpoint was there any difference?

A. There was no advertising at the beginning—this wholesale mailing crusade that is going on from coast to coast, and from Alaska to the Border wasn't in effect, and

neither were the banking institutions of the country supporting it with ads in magazines and newspapers, half pages, encouraging thrift, as they are today. The banks were trying to get savings accounts. Today they are telling you to buy defense bonds—entirely changing the situation.

Q. Is this advertising campaign the only difference in the situation of 1938 and now?

A. I am attempting, your Honor, to obviously cooperate with the Court as much as I can——

The Court: I don't want you to cooperate with me. I just want you to testify. I am asking you facts—if there [fol. 3158] is any other difference between the two between 1938 and now, between these defense bonds and the Fidelity contract. If you know, I want you to tell me.

A. There are no mathematical differences that have made any difference at this time than they did when the contract —when the savings bond was previously put on the market.

Q. You said there are some advertising differences. Are there any other differences?

A. Yes.

Q. What are they?

A. Well, for instance, when—and I understand this is pretty general—life insurance companies, for instance, are instructing their agents, when they meet the apparent competitive elements of defense bond buying, they shall encourage not only their buying more, but continue the program they have started, and from the standpoint of patriotism, support the issue of doing your share for America, which is a tremendous thing—favorable to the one and adverse to the other.

The Court:

Q. Is that all? Are there any other differences?

A. Well, there would be—as I just touched upon—with stamps. With the original savings bond, you could merely [fol. 3159] buy a bond and take your money to the post office. You couldn't send money by mail originally, until the latter part of 1940, when they did put an installment and envelope-sending system in effect on the other bond. Now you can go to your Kroger Grocery and buy your groceries, and get stamps in change. The vehicle is now made easier —the difference between buying an icebox and radio for

cash and being able to buy it on the installment plan—an entire difference in selling.

Q. Are there any other differences?

A. I don't think any material or important ones.

Mr. Huwe:

Q. And didn't the Government advertise a baby bond? They sent to you about the same kind of advertising with reference to baby bonds back in 1938?

A. They did not.

Q. You didn't receive any?

A. Not only didn't I receive any, but they didn't send them, for I made myself familiar with them.

Q. You mean to say that they didn't advertise them at all?

A. No, sir; I didn't say that.

Q. Answer my question.

A. I am answering your question.

[fol. 3160] Q. They didn't advertise them through the mail?

A. They did some advertising through the mail. You infer that they were doing as much as they are doing now.

Q. Now, how about the sale of series B of the old Fidelity to people who were physically ineligible for low premium insurance? Would there be competition by low premium insurance in such a situation?

A. That question answers itself; obviously not.

Q. Thank you. And wasn't that a sales feature and factor in the success of series B?

A. It was not.

Q. It was not?

A. That's what I said.

Q. Are you speaking about Wisconsin, or are you speaking about all the states?

A. Speaking about B wherever and whenever it was sold.

Q. You do not attach any importance to the fact that the contract holder received a certain type of protection with reference to completing the face amount of the certificate without having to have a physical examination?

A. Will you read that question, please.

(The question was read.)

A. Very definitely a benefit to the man who bought it.

[fol. 3161] Q. So it was an attractive feature to the man who could buy a series B policy who couldn't pass a physical examination for low premium insurance?

A. I don't know what you are trying to ask me. You are trying to tie two things up, but you won't let me answer them separately. I can't answer them together.

Q. You have agreed that there is the ability of a series B contract holder to enter a contract wherein, if he predeceases the face amount maturity date, that face amount maturity sum is paid up for him by some insurance feature?

A. That's correct.

Q. Is that particular feature attractive to a prospect who cannot buy insurance and who is looking at the investment from the standpoint of a savings point of view?

A. Has no benefit at all if he cannot qualify for the insurance.

Q. Does he have to take a physical examination in series B?

A. He does if he has attained the age of forty-nine and a half years, or if the sum is greater than five thousand dollars.

Q. Suppose the sum is less and he is less than forty-nine and a half?

[fol. 3162] A. Then the life insurance company passes upon what they call the medical inspection bureau reports. They rely on the system that the insurance companies use, which is a national method, which is equivalent to a medical examination to a certain extent, equivalent to it to a certain extent, because it is medical information.

Q. To a degree.

A. To a degree.

Mr. Palmer: Mr. Huwe has apparently assumed that if a person goes to a life insurance company and is refused for life insurance, he could automatically walk into Fidelity, and being under forty-nine and taking an amount less than five thousand dollars, sign a certificate that "I have been rejected by the life insurance company and therefore take series B." I don't know whether that is a fact. Before he assumes it as a basis for his questions, I think the witness should——

The Court: All that he has assumed is that a man may be under the age of forty-nine and a half years and want less than five thousand dollars, and not be in a physical condi-

tion to pass an insurance examination, and such a man may get a series B contract. Now that apparently is the fact, with some qualifications, and the witness is going ahead [fols. 3163-3171] and explaining what those are.

A. The first qualification is that the life insurance company issuing the coverage on it always has the right for the request of a physical examination, regardless of age or regardless of the amount. The other—at all times, the method employed by the institution of life insurance is medical inspection reports and the so-called "rate card" which give a complete record of previous applications of insurance, which would automatically mark anyone who had been turned down for life insurance.

* * * * * * *

[fols. 3172-3180] Q. You thought it was a good idea to emphasize the exacting law of Wisconsin?

A. Very definitely.

* * * * * * *

[fol 3181] Cross-examination.

By Mr. Ray:

Q. Your experience has been exclusively in selling, has it not, Mr. Steussy?

A. You mean, have I devoted my time to selling?

Q. Yes.

A. Substantially, yes.

Q. As special agent of the Provident Life Insurance Company, you were engaged in selling life insurance, were you?

A. That is correct.

Q. What else did you do besides sell life insurance for that company?

A. I sold annuities.

Q. But you were engaged in selling?

A. Oh, very definitely.

[fol. 3182] Q. What business experience did you have before your connection with the Provident Life?

A. Well, way back in my educational set up I prepared for business by business schooling, and I was in the general mercantile field most of my life previous to the time of entering into the life insurance business.

Q. What business schooling did you have?

A. Well, I finished the public and high schools of my home town community, which was New Glarus, Wisconsin; after that I went to a commercial academy and took a commercial business course.

Q. What was the name of that business school?

A. Capital City Commercial College, still in existence and doing——

Q. Where was that?

A. At Madison, Wisconsin.

Q. How long were you there?

A. The length of time that it took to complete the course—I can't remember at the moment exactly how long.

Q. Was it four or five months?

A. Longer than that; but it wasn't any four or five years, I would say. I can't tell you exactly how long I was there, [fol. 3183] because I took it piecemeal, for one thing, and for that reason the time doesn't follow itself. It isn't continuous.

Q. You did what?

A. I took it during so-called interval periods.

Q. I see. What do you mean?

A. I don't like to testify as to time; it seems that I went longer than I went.

Q. I see. What was your business experience before you got into Provident?

A. I was in the general mercantile business in the rural community with my father from the time I finished school until 1914.

Q. You mean in a country store?

A. I don't mean that—in a chain of stores; five, to be exact.

Q. Grocery stores?

A. Everything from silk shirts down to the buying of hides, groceries; we sold sewing machines, pianos, and so forth—large inventories and a large volume of business.

Q. And you were primarily engaged in the sales of that business?

[fol. 3184] A. I was engaged in buying, went to the market to buy—had a complete general experience from A to Z in the operation of a general enterprising business.

Q. What became of that business?

A. That is partially out of business. The real estate people have now rented it to chain stores mostly, some now owned by my father—and very successfully rented, incidentally.

Q. When did you leave that business?

A. I left when I started to enter business in my own account and went to the city.

Q. When was that?

A. That was in nineteen—just about the time of the other War; I went to Milwaukee and engaged in the mercantile business, specializing in the musical instrument business.

Q. You were still engaged in selling?

A. Engaged in buying and selling, and got in the manufacturing of pianos the following year.

Q. After that, what did you do?

A. Then I continued in that business, because connected with the American Piano Company of New York—represented them in Wisconsin, representing the highest grade, [fol. 3185] together with their cheaper merchandise. At the time the automatic pianos were losing their popularity, I went with the radio business—went into the radio business with Grisby-Grunow in the peak years of 1928 and 1929.

Q. During those years you were principally engaged in selling?

A. I bought millions of dollars of merchandise during that time and beyond the early thirties; bought hardware, wire—everything in the manufacture of pianos; had to do with the financing—had a lot of dealings with financial companies.

Q. My questions were relating to the Grisby-Grunow people. You were principally engaged in selling during those years, were you not?

A. Of course, any mercantile enterprise, everything you buy for it must be sold; otherwise you couldn't economically operate the business.

Q. That has been your specialty—selling?

A. I would say the training of help and executive capacity of a sales organization.

Q. Let us get back to the Grunow business. You were principally engaged in selling radios, were you not?

[fol. 3186] A. The training of salesmen to sell them.

Q. That is being engaged in the selling of radio equipment is it not?

A. That is right.

Q. From the Grunow people, where did you go?

A. Provident Mutual.

Q. During the years with Provident Mutual, you were principally engaged in selling?

A. Entirely so.

Q. From Provident you went to Fidelity?

A. That is correct.

Q. Have you ever been connected with Fidelity in any way but the selling department?

A. No, sir.

Q. Since you left Fidelity, have you been engaged in anything but the selling department?

A. Yes.

Q. What department?

A. I am on the so-called inter-company meetings that we have. We counsel on all the things; we have advertising—the sales of different departments——

Q. Did you——

[fol. 3187] Mr. Palmer: Let him finish his answer.

A. (Continuing) I obviously discuss investments. I made some commitments for investments, have been on investment committees, and so forth. Those policies, they are all discussed. If you become an executive of an insurance company, your duties are obviously very broad.

Q. Did you not state that you were made a vice-president and put in charge of selling this particular form of contract?

A. Yes, sir.

Q. Isn't that what you have been principally engaged in?

A. Oh, yes; principally, I have.

Q. And that is what you went there to do?

A. Oh, yes.

Q. And it was your experience as a salesman which was responsible for your going to Franklin?

A. That is also correct.

Q. What work have you ever done in any actuary department of any company?

A. Well, actually creating mathematical equations—none; checking them as to salability, desirability, usability

beneficial to the buyer—a lot of it; a lot of it for Fidelity and since—in other words, when new contracts came out, [fol. 3188] the supervisors were the fellows that were asked whether it was salable; they had control of it. There wasn't anybody in the home office—they didn't know "boo" about it.

Q. You didn't do any actuarial work on it?

A. I didn't do any of the mathematical equation work, no.

Q. What did you have to do with the investment policy of Fidelity?

A. Not a thing.

Q. What did you have to do with the investment policy of Franklin?

A. I have nothing to do with the policy. That is established and on record by the State law and the State requirements, and they certainly didn't change that because they found me.

Q. And you have made no changes in investment practices or policies or conditions at Franklin since you went there?

A. I am afraid I haven't.

Q. Did I understand you to say that the reason face amount certificates would not or could not be sold under the Investment Act of 1940 was because the loading charge was only seven cents out of each dollar paid in by the contract purchaser?

[fols. 3189-3202] A. I said the loading charge was too low, and I referred to the seven per cent of the net deposits of the purchaser, which you will find in the law, if you examine it.

Q. Do you mean by that, that only seven cents out of every dollar which the buyer pays to the company can be used for loading, and that seven cents out of every dollar paid in by the buyer is too small to carry on the business?

A. That is exactly what I mean.

Q. Do you want to make any explanation or any amplification of the answer you have just given?

A. I don't think so.

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[fol. 3203] RICKARD H. LAURITZEN, called as a witness, having been first duly sworn, testified as follows:

Direct examination.

By Mr. Palmer:

Q. State your name, please.
A. Rickard H. Lauritzen.
Q. Your residence, please?
A. Madison, Wisconsin.
Q. Your occupation or profession?
A. Attorney.
Q. What, if any, official position do you hold with the State of Wisconsin?
A. Senior Assistant Attorney-General.
Q. How long have you held that position?
A. Since March of 1939.
Q. Do you know Mr. James Fleming, the attorney for the debtor?
A. I met Mr. Fleming.
[fol. 3204] Q. And do you know Mr. Allen Messick, Chairman of the Board of Fidelity?
A. I have met Mr. Messick.
Q. During the early part of June 1941, state whether Mr. Messick and Mr. Fleming came to the State of Wisconsin, and in your official capacity, you had a conference with them.
A. They did and I did.
Q. Who else was present at that meeting?
A. Mr. Allen Pflugradt, Chairman of the Banking Commission of Wisconsin, and Robert Reiser of Madison, attorney for Fidelity Assurance Association.
Q. Will you tell the Court what was said at that conference?
Mr. Ray: We object, your Honor.
Mr. Palmer: I was asking the witness to tell the Court what was said at that conference.
The Court: Certainly everything said at that conference couldn't be said by the witness.

Mr. Palmer:

Q. What was stated by Mr. Messick and Mr. Fleming as to whom they represented, if anyone, and their purpose in holding the conference.

[fol. 3205] Mr. Ray: If it please your Honor, I object.

The Court: Overruled.

A. Mr. Fleming first stated that he represented the debtor with respect to the petition filed in this Court for reorganization, and Mr. Fleming and Mr. Messick both stated that they were authorized by the trustee to go out to the various states to ascertain what the attitude of state officials holding state deposits was with respect to those deposits.

Mr. Palmer:

Q. Thereafter was the conversation general, but with reference to Fidelity and its deposit with the State of Wisconsin?

A. It was.

Q. Were you also present at a meeting held in the City of Chicago on Friday, June 13th, about which meeting Mr. Harlan Justice had previously testified?

A. I was—that was the next day.

Q. That was the day following the meeting in Wisconsin?

A. Yes.

Q. Will you tell the Court please what Mr. Fleming said, and first with reference to whom he represented, and secondly, as to his purpose in being there.

[fol. 3206] Mr. Ray: Let the record show another objection.

The Court: Mr. Palmer, was something said without the hearing of Mr. Justice?

Mr. Palmer: No. This is cumulative testimony.

The Court: If there is any controversy, I will permit the question; otherwise I don't see any use to put in this testimony.

Mr. Palmer: Of course, since the Auditor and West Virginia State Court officials are still presenting their case, we have no way of knowing whether or not Mr. Fleming or others will be called upon to rebut the testimony of Mr. Justice thereafter. We were putting in corroborating evidence because of our lack of knowledge.

The Court: Let us see if we can get any statement on the part of the debtor.

Mr. Ray: The debtor doesn't intend to put in any evidence in respect to that question. It doesn't deem it material to any fact.

The Court: Does anybody else intend to put in any evidence on this matter? If not, I sustain the objection on the ground that it is cumulative as to this particular meeting, and we have already had one witness testify [fols. 3207-3208] to that fully, and unless there was something that occurred without the presence of the other witness, I will sustain the objection.

Mr. Palmer: If the witness were permitted to testify he would in substance relate the same thing that Mr. Harlan Justice has related.

The Court: All right.

* * * * * * *

[fols. 3209-3221] Cross-examination.

By Mr. Ray:

Q. Mr. Lauritzen, is it true that the principal object and the principal inquiries made by Mr. Fleming and Mr. Messick when they came to Wisconsin was with respect to the sale of securities by the officials of Wisconsin?

A. That was discussed, but other things as well. I can't say—I can't answer as to whether that was their principal object in coming there.

Q. Do you know that that was the matter, in their opinion, which was of primary importance?

A. I don't know, sir.

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[fol. 3222] Raymond Latta called as a witness, having been first duly sworn, testified as follows:

Direct examination.

By Mr. Palmer:

Q. Will you tell the Court your name.

A. Raymond Latta.

Q. Where do you live, Mr. Latta?

A. I live at Wheeling at the present time.

Q. And from what place were you summoned to come to this hearing?

A. Plymouth, Michigan.

Q. Were you there on a vacation or a visit?

[fol. 3223] A. Well, it's partially a visit, partially business.

Q. I believe you came here only in response to a subpoena and not voluntarily? Is that correct?

A. That's correct.

Q. Were you formerly employed by Fidelity Assurance Association?

A. Yes.

Q. For how long a period were you employed?

A. I started with Fidelity on February 12th 1941.

Q. And when did you terminate your employment with that company, either under receivership or trusteeship?

A. September 15th.

Q. Will you relate to the Court the schooling or education that you had, Mr. Latta.

A. I studied actuarial mathematics at the University of Michigan from 1929 to 1934.

Q. Actuarial mathematics?

A. Yes, sir.

Q. I presume you were a high school graduate before that?

A. Yes.

Q. After that time did you go into that business?

[fol. 3224] A. Yes.

Q. Could you tell us with what firm you were employed?

A. Well, for a year I was with a life insurance company —1934 to 1935; then in the summer of 1935 until I came with Fidelity I was with a consulting actuarial firm.

Q. Do you care to give us the name?

A. Welch and Baird.

Q. Of what city?

A. Cleveland, Ohio.

Q. State in general what your duties were with that firm.

A. We did actuarial work for various life insurance organizations, and specializing in reorganization of life insurance organizations.

Q. Did you yourself take part or take any part in aiding in the reorganization plan of any life insurance company?

A. Yes.

Q. How many different ones, if you recall, did you take part in?

A. Well, if you take all reorganizations as a class, I would say approximately fifteen.

[fol. 3225] Q. And taking individual or specific ones, how many did you take part in actively? Would it be the same number?

A. Yes, the same number.

Q. Will you tell the Court just what part you took in those reorganization proceedings, and also what part your firm took, and what part was left to others, so that we can get just your background on that.

A. My work with the firm was the supervising of the actuarial work. The firm worked out the reorganization plans and in some instances made the calculations for the valuations determining the equities. I think the calculations would cover most of them, and the plans of reorganization.

Q. Will you tell us whether the reorganizations in which you took part were in any court proceedings or under proceedings of any authorities.

A. Yes; some of them were under court proceedings.

Q. Will you tell us, did you take part in any reorganization proceedings in which the state authorities had charge by statute of those reorganization proceedings.

Mr. Ray: Your Honor, he couldn't reorganize life insurance companies unless the state authorities were inter-[fol. 3226] ested.

Mr. Palmer: I have that in mind. My question was as, distinguished between the state statutory authorities and perhaps a state court proceeding; if there is such a distinction, I wanted to determine that matter.

Mr. Ray: If there was, it was a proposition which this witness couldn't do——

Mr. Palmer:

Q. I am asking whether you took part—is my question clear to you?

A. Restate it, please.

Q. Some life insurance reorganizations occur by virtue of creditors or other persons causing court proceedings to be instituted; some occur whereby the state authorities in charge of life insurance by statutes conduct or manage the

reorganization proceedings. Now, I would like, if you could, for you to state if you have been in either or both of those types of reorganizations or taken a part therein.

A. Well, all of those I worked on, so far as I know, came under the jurisdiction of the state authorities. I can't go further on the question.

Q. Now where they were under the state authorities, how [fol. 3227] many of those fifty you mentioned would that apply to?

A. What was that, please?

Q. You said that you worked upon fifty——

A. Fifteen.

Q. Fifteen? Could you tell us how many of them necessarily included working with the statutory state officials of more than one state?

A. No, I don't believe I could state that.

Q. Were there some of them which included working only in the one state and some which included working in one state in connection with other states necessarily involved?

A. That is correct.

Q. In reference to those latter ones, were there more than one of those, that latter type of reorganization, upon which you worked?

A. Yes.

Q. With reference to those, what can you tell us as to whether the statutory officials of the state in which the life insurance had its home office or principal place of business were cooperated with by the statutory state officials in the other states in which the company did business?

[fol. 3228] Mr. Ray: We object to that.

The Court: Sustained.

Mr. Palmer: If your Honor please, we are attempting to determine whether Fidelity could have been—whether the interests properly could have been subserved by State Court proceedings. If we show that in other kinds of somewhat similar proceedings, State Court officials did work and cooperate together to achieve the end, I think that would be a matter that your Honor would be interested in, or if the State Court officials did not cooperate together and the end result wasn't satisfactory. That's what I have in mind.

The Court: When we have evidence in this particular case that the State officials are not cooperative, it seems to

me that testimony that in other reorganizations they were or were not cooperative is immaterial.

Mr. Palmer: If your Honor would refresh my memory as to the evidence that they were not cooperating—I perhaps heard the evidence and don't recall.

The Court: They stated on the record——

Mr. Palmer: I realize that the debtor passed a resolution to that effect, but so far——

[fol. 3229] The Court: I mean these representatives here, one and all stated on the record that they were not prepared to say that they could cooperate with State Court proceedings. Some of them said they wouldn't cooperaete with it; others said thy didn't know. None of them, so far as I can recall, said that they would, unless on their own terms. Do you have any difference recollection?

Mr. Palmer: I don't recall the statement of anyone that said they would not cooperate with the West Virginia State officials.

The Court: They didn't state that in those exact terms, that they would not cooperate; but they made statements which the Court could not interpret in any other way.

Mr. Palmer: That is why I wanted this witness to explain, if he could, how the various states do work together, but each retains its own sovereignty and retains jurisdiction over its own funds—for that very purpose—to show where each state has its own deposit and each its own laws, how they do work together in insurance company reorganizations to reach a final result, that they frequently do—and if this witness is familiar with the mechanics of how that is done, I would like it explained to the Court [fol. 3230] and for that reason I think it is material.

The Court: I will let him answer the question as to what the State officials did in these cases.

Mr. Palmer:

Q. Limiting my question as indicated by his Honor, Mr. Latta, would you tell us the mechanizations of how the various state statutory authorities worked together, if they would, to achieve an end result of a reorganization of a life insurance company with which you were familiar.

The Court: Your question is still objectionable, because you are bringing in the element of working together, whereas that element is not in this case.

Mr. Palmer:

Q. Will you tell us how they did work?

A. As a rule, the state in which the company was incorporated held—you might say—held supreme; in other words, the other states left it up to that state primarily, because they first had to have their approval on any reorganization plan.

The Court: I will have to rule that out.

Mr. Palmer: I was going to ask a little further. Will your Honor permit me?

The Court: All right.

[fol. 3231] Mr. Palmer:

Q. Mr. Latta, did the other states other than the home office state of the company turn over their deposits to the home state of the company or did they retain those in their own state?

A. I would have to qualify that statement. I have seen it both ways. I have seen them turned over after a a period of time, depending upon the working out of the plan. Then I have also seen them where they did not turn them over until forced; in other words, they didn't do it voluntarily.

Q. Prior to the adoption by the home office state of a definite plan of reorganization, did they ever in any case turn over the assets to the home office state?

A. I can't answer that question.

Q. Could you answer it generally or not?

Mr. Ray: If he can't answer, he can't answer.

A. It is not clear enough to me.

The Court: That is a question that can't be answered generally.

Mr. Palmer: You are right, your Honor.

Q. In the majority of cases that you worked on, what can you say as to that?

A. I don't think the number is sufficient to even answer [fol. 3232] that.

Q. What can you say as to whether or not there were conferences between the officials of the home office state and the statutory officials in other states leading to the working out or rejection of a plan by the home office state?

A. There were none to my knowledge.

Q. I beg your pardon?

A. On the plans I worked, none to my knowledge.

Q. After the home office state had worked out a plan, was it adopted by the other states or rejected by them in their discretion?

A. Yes.

Q. What can you say as to whether or not the majority of the states adopted the plan that had been proposed as satisfactory to the home office state?

A. I don't think I get that question clear enough.

Q. If a plan had been made by the home office state, it was then submitted, as I understand, to the officials—proper officials in the other states. Is that correct?

A. In some instances.

Q. In those instances, was it submitted to them for the purpose of agreeing to it or criticising it or rejecting it, or what was the purpose?

[fol. 3233] A. Depending upon whether the company wanted a license in that state, as a rule.

Q. If the company wanted to renew its license or a new license in that state, it was submitted to the officials in that state. Is that correct?

A. That is correct.

Q. And they went over the plan to find out as to whether it was a proper plan for use in their estate. Is that correct?

A. Yes.

Q. If they determined it to be a proper plan for use in their state, they so informed the state of the home office; otherwise they informed them that it was not a proper plan.

(No answer.)

Mr. T. C. Townsend: I object to this line of testimony. It is too general to be of value.

The Court: Overruled.

Mr. Palmer:

Q. Now, of the fifteen companies that you worked upon for reorganization, how many were successfully reorganized through state statutory proceedings?

A. I can't interpret that question exactly. It's too gen-
[fol. 3234] eral for me.

Q. You were working on fifteen companies, helping to try to reorganize them. Is that correct?

A. That's correct.

Q. At the time you left your employment, had reorganization been completed in any of those fifteen different reorganizations you had been working on?

A. Yes.

Q. How many of those had been completed?

A. Approximately twelve, I would say.

Q. Of the three remaining, were they still being worked upon, or had they been finished and been found to be impossible to reorganize?

A. I don't know that we can interpret reorganization—it's a rather broad statement. Reorganization, your Honor, to me means changing of a company's complete plans——

Mr. T. C. Townsend: We didn't hear that.

A. (Continuing.) Reorganization means changing of the company's complete plans, and possibly equities of the contracts involved. In some cases, some reorganization plans require years to work out, or at least to tell the tale. To say whether one is successful or not is rather a broad [fol. 3235] statement, unless defined. If you define what you mean I might——

Mr. Palmer: I understand what you mean.

Q. Had your work been completed in those other three in the company with which you worked?

A. Yes.

Q. And was the plan upon which you had worked being put into effect and operation?

A. Yes.

Q. On any of the companies that you ever worked—and I am speaking of life insurance companies—towards their reorganization, was it ever found to be impossible to effectuate a plan or method of operation?

A. That is rather broad.

Q. Sir?

A. That's rather broad.

Q. Will you narrow it as much as you wish and tell us how you are narrowing it before you answer.

A. Before a plan is put in effect, it is pretty well laid out.

Q. Yes.

A. (Continuing.) And, on the contrary, if the plan isn't, [fol. 3236] we probably didn't work on it; we couldn't have worked out a plan if it hadn't been put into effect. When

we entered the work, some of those things probably had already been determined.

Q. Now, of the fifteen companies that you worked actively upon, and particularly the twelve that you say were more or less completed, how many of those twelve became operating companies again in the sense that either due to themselves or to someone taking them over, they kept on going in the life insurance field?

A. Your question—one part contradicts the other. If they are turned over they don't keep on going.

Q. The company itself does not?

A. No.

Q. That part of it which was a part of the new company is being operated. Is that correct?

A. That's correct; that's it. If they are turned over, the equities are preserved up to that date, but they don't continue to operate as a company, so I can't answer your first question for that reason.

Q. Mr. Latta, would you explain to us the mechanics, if it isn't too broad again, of attempting to reorganize a life [fol. 3237] insurance company; what is involved and what you must look for and what you must attempt to do.

Mr. Ray: That's going too far afield.

The Court: Sustained.

Mr. Palmer: If your Honor please, that is preliminary to later questions so that the Court and counsel will understand the definition of terms that may later be inquired about.

The Court: I think we understand it. If we don't we will ask you about it and we will bring it up at that time.

Mr. Palmer:

Q. Of those twelve companies of which you have been speaking, how many were put upon or attempted to be put on a plan whereby the company itself would be rehabilitated into a new company, and how many were put into the category of a new company absorbing it?

Mr. Ray: I think we have heard enough about those twelve insurance companies. We don't know what their problems were, what the conditions were. There is nothing to show that the conditions were like conditions in connection with this company. What we are interested in is the

jurisdiction of this Court to reorganize Fidelity, but not [fol. 3238] about what this witness did with some twelve companies from 1935 to 1941. We admit he is an actuary, and he has had broad experience. Let's get down to the jurisdiction of this Court in connection with Fidelity.

The Court: Overruled.

Mr. Palmer: Will you read the question.

(The question was read.)

A. I can't answer that question. There are too many phases that I would have to discriminate in order to answer that question.

Q. Were there some in each category?

A. You might say if you have twelve companies you might have twelve categories.

Q. Now, did you make a study of Fidelity after you came to Wheeling?

A. I studied phases of it.

Q. And what phases of it did you study?

A. That's a rather broad——

Q. What is that?

A. That is a rather broad question.

Q. Did you study them from an actuarial end?

A. Some of them, yes.

Q. What else did you study?

[fol. 3239] A. Some of the financial statements—phases of the statements; some of the contracts—some phases of the contracts.

Q. Did you study any selling ends at all?

A. Very little.

Q. Did you study the investment end of it?

A. Very little.

Q. What was the purpose of your study?

A. At various times, the phase of determining the condition of the company. It changed very often—the purposes were changed very often due to the status of the company.

Q. Were you also attempting to make a study to see if Fidelity could be rehabilitated?

A. Yes.

Q. Did you formulate either roughly or fully any plans or ideas as to how far Fidelity could be rehabilitated?

A. I formulated some general ideas. I couldn't say plans—no.

Q. Did you formulate or attempt to formulate any plans whereby Fidelity would be rehabilitated or could be started again solely as a face amount certificate company?

[fol. 3240] Mr. Huwe: I object. His testimony has been that he formulated general ideas, and couldn't say they were plans. That question infers that he went further and formulated plans.

The Court: Mr. Palmer, you are asking him now whether, according to his plan, his idea—whatever you may call it, it was possible to rehabilitate Fidelity solely as a face amount certificate company?

Mr. Palmer: Yes.

The Court: What pertinancy do you think that sort of exclusive question has here? Is it your idea that the only way Fidelity can be reorganized under Chapter 10 is to reorganize it solely and only as a face amount certificate company?

Mr. Palmer: No, your Honor. My idea is that Fidelity can never be reorganized solely as a face amount certificate company, and I want to show, so we can get that feature out of the road—and then investigate the possibilities of some plan that might be possible.

The Court: That might be pertinent at some later date; but now the narrow question is whether it would be reasonable to suppose that if it were reorganized, it could be re-[fol. 3241] organized at all, whatever may be the means or methods.

Mr. Palmer: In my examination I am attempting to investigate that by breaking it into the various categories in which it is possible theoretically to reorganize it, and examine each one to see whether, as the Court has suggested, it is possible to be reorganized at all; then, if need be, we can take them into groups. To get up to that idea, you must take it into the common or basic categories in which Fidelity could ever operate in again. We can exclude, for instance, tht Fidelity could be reorganized to make fire engines or airplanes. Then as to the question of whether Fidelity could be reorganized as a bank, that is too far afield. Then we come to a face amount certificate company that would sell term life insurance, a company that would sell a combination of various life insurance. In order to test the idea whether it can be reorganized at all, it has been my idea that we should take each of the various cate-

gories and see if it could be put into that category solely.

The Court: With that understanding, go ahead.

Mr. Palmer:

Q. Did you investigate or attempt to determine whether [fol. 3242] Fidelity could be reorganized solely as a face amount securities company?

Mr. Ray: I don't think he is qualified as having sufficient experience with face amount certificate companies and with all the phases of such a company, and with all the statutes which regulate such a company, to be able to make such a study.

The Court: It seems to me that so far, his qualifications have been limited in his examination to familiarity with a reorganization of insurance companies.

Mr. Palmer: My question was only to ask him if he had made any investigation into that possibility. I don't know that he has made it.

The Court: Unless he is qualified in the first place, then whether he made an investigation would be immaterial, because anyone of a number of persons you may bring here might have made an investigation; still, that wouldn't make his testimony relevant.

Mr. Palmer: Let me see if I can understand the position that the attorney for the debtor has taken. This morning he objected to asking the witness questions about a face amount certificate company because the man wasn't an actuary, and now we bring in an actuary, and he says we [fol. 3243] shouldn't ask an actuary questions about a face amount certificate company. May I ask whom we should bring here? Various directors of the company who had no actuarial experience? Mr. Burt, who had no selling experience and testified in full how easily the company could be reorganized? Men of that sort?

Mr. Ray: Mr. Burt was president of this company for a great many years. It would be presumed he should be familiar with every phase of it. I think Mr. Palmer would have been, and I might have been.

The Court: When an objection is made, I feel compelled to rule on it, but I think the law requires, and I believe this witness ought to be qualified as to some familiarity with face amount certificate companies before we proceed along that line.

Mr. Palmer:

Q. Mr. Latta, have you studied and did you become familiar in you work with what are known as face amount certificate companies, such as Fidelity had been?

A. Phases of it, yes.

Q. Which phases of it?

A. The mathematical phases.

Q. Speaking from the mathematical end of it only then, [fol. 3244] did you investigate or did you attempt to ascertain whether Fidelity could be reorganized as a face amount securities company purely from a mathematical viewpoint?

Mr. Ray: I submit that that doesn't qualify him.

The Court: It depends on what Mr. Palmer means by "purely from a mathematical viewpoint." Do you mean by that, whether any actuarial plan could be figured out whereby a face amount securities company could operate?

Mr. Palmer: I was asking if he had considered that or thought about it. I haven't even come to the question that Mr. Ray is objecting to. I don't know the answer to that yet.

The Court: Will you read the question.

(The question was read.)

The Court: The question was as to the meaning of reorganization. That is a broad term and pursues in the Court's mind, for purposes here, the actual operation of the company after it is set up. If that question is limited to simply a consideration of whether or not a mathematical an dactuarial basis can be arrived at for such a company to proceed on, then it is all right.

Mr. Palmer: I think your Honor is right. If your Honor will hear the question read again—if he made any investi- [fol. 3245] gations; my question is to find out what he did himself towards investigating these conditions.

The Court: All right; I will let him answer the question.

(The question was read.)

The Court: Answer that Yes or No.

A. With the word "reorganization" there, I can't answer the question—with the word "reorganization."

Mr. Palmer: Strike the word "reorganization" from it then.

Mr. Jaegerman: Then you don't have any question.

Witness: Pertaining to reorganization—it is too broad.

Mr. Palmer:

Q. Did you investigate or make an attempt to find out about face amount securities as sold by Fidelity, from a mathematical viewpoint?

The Court: I didn't hear that question.

Mr. T. C. Townsend: I object. Read the question for the Court.

(The question was read.)

The Court: I overrule the objection.

A. Face amount securities? You mean contracts?

Mr. Palmer:

Q. Face amount certificates.

[fol. 3246] A. Yes, I investigated them.

Q. Did you make a study of Fidelity with the view in mind of the possible transformation of Fidelity into a life insurance company?

A. In general—yes.

Q. Did you make a study of Fidelity, in general, with a view of an attempt to rehabilitate that company into a going concern?

A. Yes.

Q. Will you tell the Court generally what you did along those lines?

A. My work along those lines was in collaboration with certain other officers in a plan that they had instigated, and it only dealt with the handling of equities of the contract holders.

Mr. T. C. Townsend: I didn't hear that. Will you read the answer, please.

(The answer was read.)

Mr. Palmer:

Q. This work was then with the equities of the contract holders? Is that correct?

A. That is correct—limited to this plan that we first talked about.

[fol. 3247] Q. Yes. Now, what did you do with reference to ascertaining what could be performed with the equities of the contract holders?

A. That's too broad.

Q. Will you tell us what you did with reference to that particular phase of your work?

Mr. Ray: I don't think that is pertinent.

The Court: Overruled.

A. I can't answer that question.

The Court: Can't you explain what you did? That is what he is asking now—what you did.

Witness: To this plan?

The Court: The question is what you did with reference to any examination of the equities of the contract holders in framing any plan as a result thereof, or any skeleton of a plan, or ideas for a plan.

Witness: There were very many skeletons made, and as I said, my work was only in collaboration in connection with how the equities—whatever they may be—could be used in applying toward the life insurance annuity contract.

Mr. Palmer:

Q. Did you attempt to work those equities of the contract holders into any form or plan for face amount certifi-[fol. 3248] cates?

A. No.

Mr. Huwe: I thought he said life insurance annuities.

The Court: He did.

Mr. Palmer:

Q. I hand you herewith two volumes, one marked "Uniform Plan," and one "Graduated Plan," and ask you if you have seen those before?

A. (Examining books:) I have seen parts of them, yes.

Mr. Palmer: Will you mark these for identification, please.

Exhibits 111 and 112

The books referred to were marked for identification respectively as above indicated.

Mr. Ray: I am going to object to the use of these because they are dated before this actuary became connected with the company.

The Court: Let me take a look at them. (The reporter handed Exhibits 111 and 112 for identification to the Court.)

Mr. T. C. Townsend: I would like to find out where these files came from. May I ask, Mr. Palmer, where did you get them?

Mr. Palmer: I think it will be disclosed in proper [fol. 3249] time.

Mr. T. C. Townsend: From the legal files of Fidelity?

Mr. Palmer: I said, I think it will be disclosed at the proper time.

Mr. Ray: Now is the proper time.

The Court: Before ruling on the admission of these, have you offered them?

Mr. Palmer: No, sir. There was an objection to my using them.

The Court: You have had them marked for identification. Are you going to ask a question about it?

Mr. Palmer: Yes, sir.

The Court: Ask your question and see if there is any objection to it.

Mr. Palmer:

Q. Handing you first Exhibit for identification No. 111, will you tell us with what parts of that you are familiar?

A. (Examining exhibit:) I am not familiar with any of the details of this particularly, except this is the part, as I recall—it is a plan in which, as I stated before, that I went into and helped collaborate with upon the plans of any equity—whatever it may be. I made a statement similar [fol. 3250] to that effect.

Q. And the same statement applies to both plans?

A. Yes, sir.

Q. Now, let me ask you this, as a general question: Is it true that the equities of the contract holders of Series A, B, and D were in proportion much greater than the equities of the contract holders of the older series of contracts?

A. What do you mean by "equities"?

Q. The same thing you do, I hope.

A. I don't understand the question, I am sorry.

Q. You spoke of equities——

The Court: Do you mean greater in proportion to 100%?

Mr. Palmer: Yes, your Honor.

A. They have a higher percentage of equity, yes; as far as the solvency of the company, the general statements show that the A, B, and D—the degree of solvency is much higher.

Q. In working out any procedure or plan having to do with the equities of the contract holders, tell the Court whether or not the fact of that unequalness of the equities in proportion to solvency of the company was a barrier or hazard that was blocking your efforts.

[fol. 3251] A. In this plan, you mean?

Q. In this or any other plan.

A. I thought you were speaking of these. That's a question we didn't know the answer to.

Q. It was a hurdle that you didn't know how to get over. Is that right?

A. As far as the exact equities, their percentage have never been determined. Various estimates have been made, but no——

Q. Did you ever attempt to find those exact equities?

A. I have worked towards them roughly.

The Court: In any reorganization, whether of this kind of company or a life insurance company, don't you ordinarily find that different creditors or policy holders or contract holders have different equities, and some of them are more nearly 100% than others?

A. Well, as far as life insurance, the only place I found that where it varied between any two contract holders, in life insurance, the only place I found that it varied was in the fraternal life insurance company.

The Court: Have you reorganized some of those?

A. That is the only place you have a general fund—a [fol. 3252] life insurance company—just one fund.

The Court: If these varying equities are determined by a Court having the power or authority to do so, then it becomes comparatively simple to work them into a plan, isn't it?

A. Yes, as far as handling—handling of the equities and use of the equities—you can figure out the equities, whether it is one dollar or one thousand or one hundred per cent.

Mr. Palmer:

Q. In any attempt, however, to rehabilitate the company before there were receivership proceedings, the fact that, let us say, the B fund had a 95% equity and the special annuity had, let us say, a 25% equity, was a difficult matter to work out. Wasn't that true? I mean, as a practical matter?

A. My experience there was they never determined what amounts each fund had. As far as working out a plan is concerned, it offered problems to what we were working toward, because we had no assumptions to make toward determining the equity of each fund.

Q. Let me develop that a little more fully. You attempted to find out how much equity or cash against liability each [fol. 3253] policy holder of each series of contracts would have. Is that correct—roughly?

A. Worked out statements of that nature revealing information of that nature, with innumerable assumptions made.

Q. What was that?

A. We tried to develop figures along that nature, with—making innumerable assumptions—a number of them, I mean.

Q. Part of the trouble was that you had loans between funds and transactions between funds and as shown by the books of the company. Isn't that true?

A. Yes, sir.

Q. And you would have to assume in some instances that the loan would be paid back by one fund to the other fund before you would work on it. Isn't that right?

A. We made various assumptions.

Q. Yes. That was one of the assumptions you made.

A. Yes.

Q. And in other assumptions, you just took the reserve as shown by the books of the company as belonging to that fund, without paying back any of its loans in other funds and worked on that assumption.

[fol. 3254] A. We made various assumptions along that line; yes.

Q. You had no way, prior to receivership proceedings being brought, of determining which of your assumptions would be lawfully and legally correct?

A. Did you put a date in there? I can't answer that with a date.

Q. You had no way of determining that any of your assumptions was lawfully and legally correct?

A. I haven't heard the answer as yet, if that is what you mean.

Q. By that you mean the answer to the question is that you had no way of determining it?

A. That's right.

Q. Now, with what other officers of the company did you work?

A. I worked with the president, vice-president and secretary, chairman of the board, and other vice-presidents.

Q. Did you work any with the firm of Koontz & Koontz, or any of the members thereof?

A. On a plan?

Q. Yes.

A. No.

[fol. 3255] Q. Did you submit any plans to them after you had finished, or did you discuss with them any ideas?

A. I discussed some ideas with Mr. Thomas, who was the receiver.

Q. Prior to receivership, it has been testified here that you and Mr. Tom Foulk and Mr. Risley attended a conference in Mr. Koontz' office.

A. We discussed some phases of reorganization.

Q. At that time had you achieved any plan which could have been presented to contract holders?

A. No.

The Court: He says he hasn't yet, Mr. Palmer.

Mr. Palmer:

Q. Did you have tentative ideas or workings on which you hoped that a plan might be built at the time you had a conference in Mr. Koontz' office?

A. We had some ideas that we hoped might work out—yes.

Q. Now, these two volumes which I have handed to you, Exhibit 111 and 112, can you tell us whether or not they were prepared as tentative or rough working plans upon which it was hoped that a plan could be worked out?

A. It was rough work, is my understanding. These were drawn up by various officers of the company to be

[fol. 3256] presented to the S.E.C. in a hearing held there on April first to discuss the rough ideas of a plan that might work out.

Q. These were not thought to be nor meant to be any finished product or plan?

A. No. That is my understanding.

Q. Yes. They were merely ground work upon which it was hoped that ideas could be based to build a finished plan?

A. That's correct.

Q. Can you tell us, if you know, where the figures used here in both of these Exhibits 111 and 112 came from?

A. I didn't see the figures in there before they were bound in the volumes.

Q. Will you tell us, can you point out what, if any, particular parts of it you worked upon?

A. I testified before that I only collaborated.

Q. Yes. Well, excuse me. Can you tell us upon——

A. By collaborating I mean discussing with the officers as to what—as to the phase discussed in there.

Q. In other words, there wouldn't be any particular part that you could say, "I worked with the president in pre-[fol. 3257] paring this particular page" or something like that?

A. No.

Q. It would be a joint or group work of yourself and a number of officers in collaboration and discussion of ideas, and these would be the rough setting down of the joint thought?

A. That's correct.

Mr. Palmer: With that thought in mind, your Honor, I believe they became relevant to be offered in evidence now for that purpose only, and not that they represent the facts or figures set out there are correct, but only to show a—what the witness has called it—rough working sketch or outline jointly contributed to by the various officers; as I say, not for the purpose of showing that any of the figures or tables represent correct figures or purport to.

The Court: Is there any objection to the offer of these two booklets?

Mr. Huwe: Your Honor, we object and will say that only the parts which Mr. Latta can particularly point out as his contribution should be admitted and not generally.

Mr. Ray: It's quite hard to know what to say about a thing of that kind before you know what is in it.

[fol. 3258] The Court: As I understand it, the offer is for the purpose of showing that there was a plan, or maybe more than one plan, of reorganization being considered prior to receivership, and that these booklets outline the plans that were being considered.

Mr. Palmer: There were two different plans which handled the equities of the contract holders in different respects. Am I correct in my distinction of that, Mr. Latta—uniform and graduated plans? Each handled——

Q. You mean handling or allocating?

Mr. Palmer: Allocating equities.

A. Yes.

Mr. Ray: I am inclined to think that they are relevant.

Mr. Jaegerman: If I understand Mr. Palmer's offer, it is hardly necessary to have them in—just to show that there was a plan considered.

The Court: Then this is the plan.

Mr. Jaegerman: Do you offer it for its contents?

Mr. Palmer: To a limited extent. I am not offering that the figures are correct or that they represent the accurate figures of what they purport to represent.

The Court: I will permit them to go in.

[fol. 3259] Exhibits 111 and 112

The books referred to were admitted in evidence, having been previously marked, respectively, as above indicated. The same are attached hereto as a part hereof.

Mr. Palmer:

Q. Now, Mr. Latta, you recall that the state receivership proceedings were brought on April 11th, 1941?

A. Approximately that date, yes.

Q. And you further recall, do you not, that Mr. Ross Thomas and Mr. Isaiah Smith were appointed State Court receivers?

A. Yes.

Q. And you were an employee under that receivership?

A. Yes.

Q. Did you continue the work which you had been doing prior to receivership in attempting to work out the equities and the allocation of them towards the general idea of pre-

paring a plan of rehabilitation of Fidelity either yourself or in collaboration with others?

A. Yes. We took some steps along that line—yes.

Q. Did you go so far as to put into a rough plan some of your ideas in that regard? (Handing paper to witness.) [fol. 3260] A. Examining paper:) This doesn't apply, in my opinion, to the last question.

Q. To what does this paper which I have just handed you apply?

A. That applies to a memorandum on ideas that might be applied to some plan of reorganization of Fidelity under the State Court. The last question, as I recall it, referred to equities.

(There was a discussion off the record.)

Mr. Palmer: I would like this marked for identification.

Exhibit 113

The paper referred to was marked for identification as above indicated.

The Court: May I see that, please.

(Mr. Palmer hands exhibit to the Court.)

The Court: From my brief examination of this paper that you handed me, I presume that you are undertaking to show that there was a plan being developed under the receivership which had some fair possibilities in it. Now, you have also taken the position, as I understand it through this litigation, that for the purposes of good faith of this petition, there is no feasible plan of reorganization under [fol. 3261] Chapter 10. To proceed with this, I would like you to develop, if you can, any reasons why there would be a feasible plan under the state procedure and none under Federal procedure.

Mr. Palmer: I had that intention with this witness to develop that. Might I also state that I think, as stated before on the record, that it is the opinion of myself as counsel that while a life insurance plan is feasible in the State Court, it is not feasible in the Federal Court because of my own personal view of the law that this Court cannot reorganize Fidelity into or keep it as an insurance company for the reason that I think this Court has no jurisdic-

tion to give birth or to help grow an insurance company where it cannot bring it its demise or obsequies.

The Court: You think that because this Court can't be an undertaker, it can't be an obstetrician?

. . . . . .

[fol. 3262] Mr. Palmer: We would like to introduce this Exhibit 113 in evidence for the same purpose that the others were introduced.

The Court: It may be admitted.

Exhibit 113.

The paper referred to, having previously been marked as above indicated, was admitted in evidence. The same is attached hereto as a part hereof.

Mr. Palmer: Exhibit 111 and 112 apparently show that some of these figures were prepared prior to your coming to Fidelity. Will you tell the Court about that, why they appear to be that way, and whether this is the actual thing that you worked on.

[fols. 3263-3264] A. They are the plans, as I say—not working on—but I collaborated on; the figures that were explained to me were based upon statements that were prepared as of December 31st. The plans, as I recall, were brought together some time during the month of March, but the figures were on the basis of some statement prepared as of December 31st, of which I took no part in.

. . . . . .

[fols. 3265-3269] Q. From your experience and study, Mr. Latta, if there had been a rehabilitation of another face amount securities company through statutory or court proceedings, would you have known of that fact, of the conversion?

A. Not unless it was converted into a life insurance company; otherwise I would have no reason to pay much attention to it.

Q. Do you know of any such conversion into a life insurance company?

A. I don't know of any, no.

. . . . . .

[fol. 3270] Mr. Palmer: I will make an offer. When the witness conversed with me, he expressed the opinion that [fol. 3271] this company could not be rehabilitated in the Federal Court because he knew generally of the mail sent to contract holders, particularly the older series, and it had been returned because the person was either dead or was not able to be located, and that returned mail was in such a proportion to indigate that two-thirds of the contract holders, particularly the older series, could not express their desires one way or the other.

Mr. Jaegerman: I think Mr. Palmer knows that under the Act, it is two-thirds of the creditors who filed their claim; if they aren't located to file their claims——

Mr. Palmer: I know; what I wanted to make was an offer into the record, and I have made that offer.

Mr. Huwe: I move that it be stricken on the ground that it involves a conclusion of law for which this man is not equipped to give such an opinion to Mr. Palmer, to be second-handedly prof-erred into the record.

The Court: It has already been stricken, but I will permit it to be proffered on the record.

Mr. Palmer:

Q. Mr. Latta, is it not true that before it can be determined whether or not any plan can be made, that the first thing that must be ascertained by any Court is the equity [fol. 3272] of each contract holder.

The Court: That question is objectionable because it calls for an opinion on the part of the witness as to what the Court would be required to do. He is not qualified as to that.

Mr. Palmer: This is as to a practical matter, not as to a legal matter.

The Court: You asked what it was necessary for the Court to do as prerequisite to a plan.

Mr. Palmer:

Q. Before any plan can be attempted to be formulated by anyone, is it not true that the exact amount of the assets of the company would have to be ascertained?

A. No, I don't think so.

Q. You would have to obtain approximately the exact amount of the assets of the company?

A. Before any specific plan applying to contract holders—naturally you would have to determine the amount of equity that had to be applied to the plan.

Mr. Palmer: That is what I am getting at.

Mr. Ray: You wouldn't have to determine what they had at all under any circumstances.

[fol. 3273] (There was a discussion off the record.)

Mr. Palmer: So that the first step will necessarily be to determine approximately the assets? Is that correct, Mr. Latta?

A. I don't know what you mean—first step. That would have to be done before you could offer something definitely to the contract holder. I don't see that that would be the first step toward a reorganization plan. "Reorganization plan" is a rather broad term. It is like speaking of the whole government.

Q. Then you would have to ascertain the equity of each contract holder in the assets? Is that true—that would have to be determined?

A. Will you restate that, please.

Q. You would have to ascertain the equity of each contract holder in the assets of the company? Isn't that true?

A. It is part of the plan, in my opinion. You would have to do that before you could apply any equities to the plan; that depends on your definition of a plan.

Q. Now, in Fidelity, is it not true that you have questions—I am not stating that you may know the answers [fol. 3274] to or that you may not—but you have questions which involve the various series of contracts, and the relationship of the contract holders of each series to the other, as you have previously explained. Isn't that true?

A. That I have explained?

Q. I am sorry; I don't hear you.

A. You say, that I have explained?

Q. Yes. Didn't you explain that?

A. You are talking about the solvency of each fund?

Q. Yes.

A. Yes, so far as—as far as mathematically speaking, you cannot determine the exact solvency of any fund due to the problems that are presented, you might say.

Q. Isn't it true that until there has been a decision of law, there arises a problem concerning the deposit of each state as regards to the contract holders of that state?

A. I can only answer that broadly, and that is, that naturally anything that an actuary can work out is only an assumption. So far, no definite answer has been given to me whether the location of assets mean anything, or how to consider them in making a statement. It has all been in a memorandum form.

[fol. 3275] Q. If it should be determined by a judicial body or proceedings that all of the assets could be put into one jackpot and divided among the contract holders in proportion to their own claim, you would have one method of calculating, whereas if you determine it according to series claims, there would be a different method of determination. Is that correct?

A. Naturally, if you consider each fund separately, it would be different from considering all funds in one jackpot.

Q. If besides that, you considered that in each state the state depository fund bore a different degree of solvency to that of every other state, if it should be held that each of those state depositories is a separate fund, that would again complicate your problem to that greater extent. Isn't that true?

A. Naturally you would have different categories, if you take into consideration the various state deposits.

Q. And no actuary could work out a plan until those questions had been legally determined. Isn't that true?

A. A plan would mean nothing with only assumptions. We have made assumptions. Naturally we have had no [fol. 3276] answers—as I have stated several times.

Q. You would need a legal determination of those questions that I have been discussing with you just recently before you could actually put some base under your assumption?

A. Yes.

The Court: I believe Mr. Palmer may not have understood the witness in some of his previous testimony. I understood him to say that there is a difference between devising a plan and then working out that plan, and that it is possible to devise a plan even before the equities are determined or the legal principles relative to the various funds are determined, but that before the plan is put into operation, they would have to be determined. Is that correct?

A. Yes.

Mr. Palmer;

Q. And it is further true, is it not, that in order to help a person to determine whether they would like that plan, you would have to solve these difficulties that I have been talking about in order to let them know whether they were getting 100% or 50% equity. Isn't that correct?

The Court: That is a legal conclusion to be determined [fol. 3277] by the Court.

Mr. Palmer: I suppose it probably speaks for itself.

Q. In the various ways of determining equity—you would have to work them out in their various funds in order to let each contract holder see how he would stand in reference to any particular fund before he could determine whether he would like that plan?

The Court: That's obvious.

A. Yes.

The Court: The distinction that is in my mind—if you want to clear me up I would like you to do it—the distinction is that there may be a plan, and a feasible plan, under the contemplation of Chapter 10, and yet at the same time, we may not know in advance what the equities of the various contract holders are, but the equities, when determined, can be fitted into the plan that is already there.

Mr. Palmer: With this exception: There can be a plan, but I doubt whether there can be a feasible plan in view of what I have been saying, because the Court would be unable to determine whether the plan would give any likelihood of being accepted, for if the old series of contracts [fol. 3278] were going to get nothing back, and A, B, and D were to get 100%, the Court would very probably know that the holders who were going to get nothing would say they refuse any plan whereby the A, B, and D series were entitled to get 100% back; but on the contrary, if the plan indicated that they get back 80% as well as the old series were to get 80%, then the holders of A, B, and D might be said to say that they would refuse that until that was determined—so that with the exception of the question of feasibility, I believe your Honor is right that a plan can be worked before the equities are determined; but until the equities are determined, it is impossible to say it is feasible, because as I understand feasible—it means acceptable and workable—with the equity holders.

The Court: This Court has already indicated that there wouldn't be any plan considered at all except one that would give each contract holder his full equity. Now then, if the contract holder or group of them were advised that it had been decided his equity was 80% or 100%—now here is the plan into which this equity of 80% or 100% is fitted—then it just seems to me at this stage that there wouldn't be any question there as to whether or not that contract holder [fol. 3279] would accept or refuse that plan on any ground, because when it is presented to him, he knows what equity the Court has determined he is entitled to—then it seems to me that this question that you are bringing in has no place.

Mr. Palmer: Let me explain it this way, your Honor, more practically. One of the two older series owes another series certain money, evidenced by a note. Now suppose the Court would hold that the series which owes the money—the contract holders of that series were entitled or had a lien on that part itself. They didn't have to pay back that note, but that the other series just came in as a general creditor behind those contract holders. Now, in that case, it would mean that the holders of contracts in that fund would get about thirty to fifty cents on the dollar, and the fund to which the money was owed would get, say, eighty to ninety cents on the dollar. Now if, on the contrary, the Court would determine, as a matter of law, that the fund which owed the money should pay it back first, then the holders of the fund that owed the money would get nothing at all, and the holders of the fund into which the money would be paid would get one hundred cents on the dollar. Those [fol. 3280] getting nothing would reject such a plan.

The Court: Suppose the Court would say, would you approve of a plan or reorganization under which you get 80% or would you prefer to have the entire matter liquidated.

Mr. Palmer: Now, in answer to that, in the first case, where the contract holder got 80% by reason of the fund not being repaid to it later in the series—the B fund—then that contract holder will say, "I am only going to get 80%. I might as well take a chance on that 80%, and it might work out." If the Court says, "I will require that fund be paid back," and the man says, "I am going to get 100%. I am going to get it out now, because I have one hundred cents on the dollar and will keep it, rather than gamble on

a new company; but if I am only going to get eighty cents or ninety cents, I may take a chance on getting more, although I realize the Court will give me everything I am entitled to."

The Court: Suppose the Court should approve of a plan of paying off, and going ahead with some reorganization and then continuing with the other?

Mr. Palmer: Then we would be back to the State Court [fol. 3281] because if two-thirds of these groups don't agree to the plan, and the plan merely says we are going to liquidate——

The Court: It depends on what you call "groups."

Mr. Palmer: If your Honor please, I have contended from the start, if the Court is going to say, "Fifty per cent of you can get paid off in cash—now take the other fifty per cent into reorganization"—that that's what we could have done and intend to do in the State Court; and that is what this Court isn't permitted to do, and one of the reasons I object to the Federal Court jurisdiction. Two-thirds of the group must agree to the plan. If fifty per cent say, "We want cash," and whoever is in charge says, "We will give you cash," and the other fifty per cent says, "We are willing to reorganize"—that is what we could do in the State Court, and I don't believe this Court——

The Court: Who is going to say who composes the various groups?

Mr. Palmer: Some judicial body or personage will have to make that decision.

The Court: That's what I thought.

Mr. Palmer: Whether that would be this Court or some other Court, it will have to be a determination whether [fols. 3282-3295] it shall be the series groups—117 groups, considering state lines and series—or one entire group; but still, you must have two-thirds of that group, and our contention is that if in the State Court you get 50%, you can pay those off and go on with the rest of the group, but in this Court, you can't do that, and that is one of our bases of opposition to the debtor's petition.

The Court: I didn't mean to start an argument.

Mr. Palmer: I didn't mean to make a speech on our position.

Mr. Jaegerman: I want to say that I can't agree with Mr. Palmer's interpretation of the statute with reference to the plan.

Mr. Palmer: Why don't you say you prefer the Federal Court, and so state it?

The Court: I don't think it matters which one either one of you prefer.

. . . . . .

[fol. 3296] Q. Can any life insurance company continue in existence that remains static and does not sell any policies?

Mr. Ray: I object to that, your Honor.

The Court: Overruled.

A. You mean by remaining static they do not sell any policies?

Mr. Palmer: Yes.

A. The company can't remain static and not sell policies.

Q. That's my question. If they don't sell policies.

A. If a company doesn't sell policies, they are under a [fols. 3297-3299] voluntary—they are naturally liquidating; they are not liquidating as far as assets are concerned, but liquidating as far as contracts are concerned, so far as volume of business is concerned. Theoretically a life insurance company is supposed to be able to liquidate; in one sense of the word, the figures are set up that they could liquidate down to the last person, but by that theory it is overlooked the fact that life insurance is made upon large numbers, and when a company is going down and liquidating and getting down to a few numbers, you have no average set, because you are referring to the specific case; therefore a mortality table means nothing when you are talking about a few individuals. It can only be applied to a large group.

Q. Therefore you must keep that large group to keep this law of averages working?

A. You must have a large enough number. The practical thing is that a company that does not get new business does not have new rates upon which they have policy holders which have been newly examined. If you take a specific group of policy holders that were examined years ago, the mortality may exceed 100%, while those that have been newly examined have been as low as eight to ten to twelve per cent.

. . . . . .

[fol. 3300] Q. Now, can you tell me from your experience in the actuarial field if it isn't true that life insurance companies generally have lost money on annuities due, in part, to the fact that very healthy persons seem to desire the life annuities, and the mortality table has been very different from the mortality table for death under life insurance?

A. Well, as stated before, the result is exactly the opposite as life insurance. I might answer it this way. For years and years they have studied life insurance and established records in statisties on that, while life annuities have not been issued and a study has not been made for that for a sufficient period of time under the present conditions [fols. 3301-3303] in order for you to even know too much about it.

Q. And haven't you had to disassociate the mortality table for life insurance from the mortality table for annuity?

A. As a rule, a different table is used.

Q. And hasn't the annuity table been continually changing in the last few years—that is, the table used by the companies?

A. Companies—some companies keep changing the table they use, is how I might answer that.

Q. And isn't it true, or if you don't know, please so state—that because of the apparently erroneous calculations made by the companies, that they have—as it is called—lost money by virtue of the annuity table as contrasted with making a profit by virtue of the mortality table used in life insurance?

A. Well, it is the general consensus that money is being lost.

Q. By all of the insurance companies?

A. Not all of them—in general, I would say.

* * * * * * *

[fol. 3304] Q. With reference to Exhibits 111 and 112, can you tell us briefly what the difference is between the so-called uniform plan and the so-called graduate plan.

A. Well, as I testified before, I stated that those two exhibits were rough ideas of plans that may be used.

Q. I meant the difference in the terminology of the two words.

A. The graduated plan meant applying this percentage equity—in other words, a person's equity would be the

percentage determined by that fund alone, while the uniform plan was treating all funds alike; in other words, if one contract holder in one fund received 80% or 85%, the contract holder in another fund received 80% or 85%.

Q. And in the——

[fol. 3305] A. In other words, all contract holders of all funds were treated by the same percentage; they would receive the same percentage of their reserve.

Q. And in the graduated plan the A, B, and D contract holders would receive 90% of the special income, special annuity, and the remainder would receive thirty to fifty per cent?

A. It would vary according to each fund. I don't recall as to how each one varied.

Q. Now, you told us about these plans being worked out more or less cooperatively with a group—no one person working on any particular portion. Is that correct?

A. That's my understanding of it, yes.

Q. And you never devoted your entire time, or attempted to, getting up some kind of a plan, did you?

A. No.

Q. And after the State Court receivers were in, you still had other duties whereby you couldn't devote your entire time to preparing a plan. Isn't that so?

A. That's right.

Q. Do you know whether or not a plan was ever arrived at by the group in which you worked or by any other [fol. 3306] group separately which could be put into effect?

A. There was none to my knowledge.

Q. Over how long a period were these various plans worked upon?

A. I couldn't answer that.

Q. (Continuing:) To your knowledge?

A. Some of them were in process when I became affiliated with Fidelity.

Q. Did each of the plans have in the background or as its basis the idea of Fidelity as a life insurance company?

A. While I was affiliated with Fidelity, I heard of no other plans than of it planning on becoming a life insurance company; in other words, all discussions with me were on the assumption that it would become a life insurance company.

Q. And all of your thoughts and suggestions and efforts which you would contribute to the group from time to

time were on that assumption or background. Is that correct?

A. That is correct.

Q. Did you ever attend any conference with the Securities and Exchange Commission or any of their commissioners in Washington?

A. I attended one conference there, April 1st 1941.

[fol. 3307] Q. In Washington?

A. In Washington.

Q. And at that time, was an attempt made to give the Securities and Exchange Commission some idea or rough plan—rough idea of a plan—which it was hoped might be able to be worked out?

A. As I recall, this Exhibit 11 and 12 that we were discussing a while ago was presented to the S. E. C. at that time, and there was considerable discussion on those plans.

Q. And Mr. Arthur Koontz was the one who was spokesman for your group in presenting those; he was there and made their original introduction?

A. He made the introduction, I would say.

Q. Who else was there?

A. Mr. Goldsmith, also of Koontz & Koontz, and F. S. Risley, the president, Mr. Frank McNulty and Mr. Pulfer and Mr. Clarke of Haskins & Sells, and Mr. Carver and Mr. Jaegerman and Mr. Jackson of the S. E. C.

Q. Was the discussion general with the idea of attempting to solve some way out of Fidelity's difficulties?

A. The understanding I had, the attempt was—they were attempting to agree more or less with the S. E. C. that [fol. 3308] some plan could be worked out whereby Fidelity may go through a voluntary reorganization. That was the whole entire intent and purpose of the meeting.

Q. What was the attitude of the S. E. C. or those who were there to speak on its behalf?

A. They didn't believe that the plans presented—Exhibits 11 and 12—as I recall, their chief objection was that the financial status had not been sound, based upon the status in those exhibits.

Q. Did they offer any suggestion of a plan?

A. The one point that I believe that they contributed was that the company should have some kind of "umbrella"—as they used the term—in other words, they must be protected by the Court to prevent a run on future cash liabilities.

Q. During the time of the conversion?

A. During the time of the voluntary reorganization.

Q. That was the suggestion to the S, E. C.?

A. Primarily, I think that was.

The Court: Wait just a minute. How were those two ideas reconciled—the two ideas of protecting the company by the Court, and at the same time, voluntary reorganization?

A. That was what I could never understand. If it was [fol. 3309] to be protected by the Court, I couldn't see that it was entirely voluntary, unless the company was voluntarily going into Court for a reorganization, rather than being pressed by some other outside creditors.

The Court: Are you speaking about Chapter 10?

A. Of course, no chapter was referred to. I don't know what else it could be. I stated that that was the suggestion offered. That might have been the point, it appeared to be to me, that they were most insistent upon, but as I understand it, it didn't seem voluntary to me.

Mr. Palmer:

Q. Mr. Sims and Mr. Justice were present?

A. I don't believe either were present.

Q. And isn't it true that Mr. Goldsmith and Mr. Koontz, after the point was raised, discussed the possibility of putting an umbrella over the company by State Court proceedings?

A. I don't recall it being discussed with me.

Q. I mean, at the meeting—at the S. E. C. meeting?

A. Not to my knowledge.

Q. Did the S. E. C. state whether the umbrella should be in Federal or State Court proceedings, or did they state any court?

[fol. 3310] A. I don't recall any specific manner to be used; that is the reason I used the term as they did—an umbrella—because they generalized it as a method of protection.

Q. They just suggested that the legal processes of the Court be used to protect the assets of the company from a run on it during the process of attempting to evolve some sort of a voluntary rehabilitation?

A. The point wasn't covered too far; I wouldn't want to make the interpretation.

Q. Would my statement be a fair general statement, or would it be too specific?

A. I think that is the general idea. It was to prevent a run for the cash liabilities, as I understood it.

Q. During the period during which the company was to attempt to voluntarily rehabilitate itself into a going life insurance concern?

A. That is correct.

Q. And that was the apparent hope of each and all of those at that conference that that could be done?

A. Will you read the question?

Q. I withdraw that question and state it this way: It was the apparent hope of everyone present that Fidelity could [fol. 3311] be rehabilitated into a going life insurance concern?

A. That appeared to be the hope of everyone, yes, sir.

Q. That was apparently why they were there, to see if it couldn't be worked out?

A. That is correct.

Q. Did the S. E. C. or the gentlemen there at that conference have any specific ideas as to any plan which could be worked out?

A. I think they made themselves clear that that wasn't their objective.

Q. I see.

A. (Continuing:) That they were sitting in on a conference or hearing and listening to what we had to submit; it wasn't their job.

Q. Their purpose was not necessarily criticism, but raising proper objections to any plans that you would have presented to them, and not their purpose or design to build a plan for you and work on it. Is that right?

A. Well, I don't know in a sufficient amount of what preceded our going there; to answer their purpose—I can't answer for them.

Q. Did you ever see any rough draft or purported plans [fols. 3312-3319] of any kind supposedly prepared by the S. E. C. or anyone connected therewith for the help and aid of Fidelity?

A. I did.

[fol. 3320] RAYMOND LATTA, the witness who was testifying at the time of adjournment, resumed the witness stand and continued his testimony as follows:

Direct examination (continued).

By Mr. Palmer:

Q. Mr. Latta, how did you happen to go with Fidelity? What person or persons in Fidelity was responsible for that, if you know?

A. That I don't know.

Q. You were offered the employment and accepted it?

A. That is correct.

Q. We were speaking last evening when we closed about the April 1st meeting in Washington with the S.E.C. Would you again state, to refresh my recollection, all of those who were present at that meeting?

Mr. Ray: Your Honor, that is in the record.

[fol. 3321] Mr. Palmer: I said to refresh my recollection.

The Court: I think I will let him state it, because I suppose Mr. Palmer didn't take down the notes.

A. Those representing the S.E.C. were Mr. Jaegerman, Mr. Jackson, Mr. Carver. There was Mr. Koontz and Mr. Goldsmith of Koontz and Koontz.

Mr. Palmer: A little bit louder.

A. Mr. Koontz and Mr. Goldsmith, Mr. Risley, Mr. McNulty, Mr. Pulfer, and Mr. Clarke of Haskins & Sells and myself.

Mr. Palmer:

Q. There was taken over there and presented to the S.E.C., was there not, some form of tentative or rough plan for voluntary rehabilitation of Fidelity?

A. That is correct.

Q. That plan was in typewritten form, is that correct?

A. That is correct.

Q. When was that plan put into typewritten form, if you know?

A. Well, just prior to going over to the meeting.

Q. Just prior to going into the meeting or over to the meeting.

A. Just prior to leaving Wheeling for Washington.

Q. That plan, as I understand it, was more or less the [fol. 3322] joint or cooperative work of a number of officers and employees of Fidelity, is that correct?

A. Yes.

Q. Who all took part to any appreciable extent in helping formulate the ideas or various parts of the plan?

A. Well, I can't state that definitely. Some of those ideas had been prepared prior to my going with Fidelity.

Q. Well, after you got there, did Mr. Risley partake of part of the work?

A. Various parts of it we advised and used in a plan where Mr. Risley and Mr. McNulty and, as I recall, Mr. Messick and Mr. Pulfer all contributed various ideas. Beyond that I don't know what individuals were involved. There were others.

Q. Together with yourself to some extent?

A. Yes, I collaborated.

Q. To your knowledge, how far had that plan that was presented that day been discussed with Mr. Arthur Koontz before it was presented?

A. You mean the one that was presented in typewritten form?

Q. Yes.

A. Well, it was only completed just before we left for [fol. 3323] Washington and about in—I don't know what was discussed with him.

Q. So far as you know, he had not seen the plan prior to its presentation?

A. Well, so far as I know. I had not had an opportunity to see the plan myself.

Q. It is your understanding, is it not, that Mr. Arthur Koontz had arranged this conference and that the officers and those who had worked on the plan were to be present to present it to the S. E. C.?

A. I don't know how the arrangements were made.

Q. That plan provided for a voluntary acceptance by the contract holders, is that right?

A. That is right.

Q. And did it also provide thatt hose who didn't want to accept it wouldn't have to?

A. That is correct.

Q. Now, tell the Court this. Those who did not accept the plan, would they be the same or better off or worse off than those who did accept the plan?

The Court: How would he know?

Mr. Palmer: From the plan, your Honor.

[fol. 3324] A. Well, the plan provided that those who accepted—those that voluntarily accepted the plan would take a loss, which would be used to cover deficiencies. Those who did not accept the plan, their contract would continue as it is.

Q. So that one of the major difficulties with this voluntary plan was that those who did not accept it would be—if the plan were accepted by the others—better off than those who did accept the plan voluntarily? Is that in effect correct?

A. Well, one takes a loss and the other doesn't.

Q. Will you explain that by example to the Court? For instance, suppose there were a three-million-dollar deficit and a thousand contract holders, five hundred of whom accepted the plan and five hundred of whom did not. Will you give the Court—use that or some similar example a concrete basis to show how those who accepted would be worse off than those who did not accept it?

A. Well, as I recall, the plan it provided for—that is, the uniform plan provided for, assuming a 15 per cent decrease in their equity. Therefore if a person had a hundred-dollar equity, if he accepted the plan he only re-[fol. 3325] ceived eighty-five dollars, while if he didn't accept it, his equity still remained a hundred dollars.

Q. When you use equity in that sense, will you give your definition of the word "equity"?

A. Well, that is the amount he has coming from the assets that are held by the company at any given time.

The Court:

Q. You mean according to his contract; not according to the amount available to pay him?

A. That is right. His claim.

Q. So what you call his equity may be something different from what his actual equity was?

A. Well, no. As a rule I don't call equity that. I call equity the amount he has coming in proportion to the claim.

His contract called for a claim of a hundred dollars, but the plan provided that if a sufficient number would reduce their claim from a hundred dollars to eighty-five dollars, the company became solvent then. Of course, their equity would be to the extent of their claim.

Q. What I am driving at is this: If this company was insolvent to the extent of, say, fifteen per cent and everybody had an equal priority with reference to his claim, then the equity would actually be worth only eighty-five per cent of the amount of the claim?

[fol. 3326] A. That is correct.

Q. So when you say they would take a reduction in their equities, you don't mean that strictly, do you?

A. After the plan was completed, if a sufficient number covered the deficiency, then the equity in both cases would be a hundred per cent of their claim. In one case their claim would be eighty-five dollars, while in the other instance it would be a hundred dollars and their equity would be reduced accordingly. Their equity as termed in percentage, however, would always remain the same in proportion to the claim. If he reduced his claim, then his equity is reduced in proportion.

Q. Well, now, if the company is actually ten per cent insolvent and two-thirds or approximately that of the total number of contract holders were willing to take a cut of fifteen per cent in order to pay the other one-third, then that would conform roughly to the outline of the plan?

A. That is correct.

The Court: All right.

Mr. Palmer:

Q. What did Mr. Pulfer have to say as to whether that plan could be put into practical effect, and by what means of contacting the contract holders?

[fol. 3327] Mr. Ray: Your Honor, that would be hearsay. Mr. Pulfer has been here.

The Court: I don't see the materiality of that. If you will explain it——

Mr. Palmer: If your Honor please, we want to show admissions of the Debtor—I mean admissions against interest—and we want to show particularly what was attempted to be done by the Debtor and how it was attempted to be done.

In other words, I understand Mr. Pulfer, being a man of wide selling experience, was speaking for the group in explaining to the S.E.C. how you could get this plan over to the contract holders and get their consent and I wanted the witness to go into that phase of it.

The Court: But you didn't ask Mr. Pulfer anything about that. He was on the stand for examination——

Mr. Palmer: Mr. Pulfer forgot to tell us that he was in Washington, your Honor, and I didn't know it.

The Court: If he wasn't asked, I don't know that he had any obligation to tell you that.

Mr. Palmer: The Debtor didn't bring that out. The Debtor was the one that knew he was there; I didn't know it.

Mr. Huwe: Your Honor, this uniform plan calling for [fol. 3328] eighty-five per cent was the combined work of a number of people. It was in existence prior to the receivership and had been in the possession, I presume, of Mr. Palmer for a long time and one of the strongest parts of it is:

"It is proposed to secure the exchanges by both personal solicitation and mail. The selection of the method to be used will depend largely upon the residence of the contract holder."

That probably is Mr. Pulfer's contribution to this plan. This was in Mr. Palmer's control. While Mr. Pulfer was on the stand he could have asked him about it then. Even though he didn't know Mr. Pulfer was in Washington, he did know Mr. Pulfer contributed to the plan.

Mr. Palmer: I beg your pardon. I did not know it.

The Court: Sustained.

Mr. Palmer: I would like to make a proffer that at this meeting at which there was a general conversation with the S.E.C. Mr. Pulfer advised the S.E.C. that within sixty to ninety days he could get in touch with a sufficient number of contract holders, that the plan would be accepted, and that he could do this by direct mail first and by personal contact later so that the plan was a practical feasibility to be put in operation at that time; and that the Securities [fol. 3329] and Exchange Commission thereupon raised the objection that it could not be done within the time limit set.

Now, if your Honor please, I offer this not as what Mr. Pulfer said, but as part of the general conversation about

this particular plan by the officers of Fidelity in their meeting with the S.E.C. in Washington. It is nothing against Mr. Pulfer or in any way detrimental to Mr. Pulfer. It was merely what the company was attempting to do at that time; and we want to show the various steps the company has taken in attempting to pull itself out of the difficulty before state receivership proceedings were brought; and I think what anyone contributed to that desire to help themselves should be relevant to this issue here.

The Court: I can't see how what Mr. Pulfer said in that conference would be relevant, because if it were, every single thing that was said in the conference would be and also every single thing that was said in every other conference that was held with reference to rehabilitating the company, and I am confident that that is not so and I sustain the objection.

[fol. 3330] Mr. Palmer:

Q. What if any other objections did the Securities and Exchange Commission raise to the plan other than those that you and I have already discussed, Mr. Latta?

A. I don't know what objections—any other objections particularly raised to the plan.

Q. Did they raise any objection as to the fact that the contract holders who did not accept would be better off than those who did?

A. I don't recall any specific objections there, no.

Q. Did they raise a point as to whether it could be put into practical effect by getting in touch with the contract holders as the plan suggests in the way Mr. Huwe read?

A. I think they covered that point particularly.

Q. Did the Securities and Exchange Commission approve the plan?

A. No, I can't say they approved it, no.

Q. After that meeting in Washington, was there a further meeting in Charleston? If so, who attended it?

Mr. Ray: Your Honor, isn't he going all over the same ground?

Mr. Palmer: Same ground as what?

Mr. Ray: That you went over yesterday.

[fol. 3331] Mr. Palmer: I am sorry. I don't think so.

Mr. Ray: You asked about meetings in Washington yesterday and about meetings in Charleston yesterday.

The Court: I don't remember his asking about a meeting except for Washington. Overruled.

A. I don't know of any meeting, no.

Mr. Palmer: I beg your pardon?

A. I don't know of any meeting.

Q. Well, did you and others meet in Charleston?

A. We left Washington and came to Charleston.

Q. Did you have a conference about Fidelity?

A. Yes, we had conferences. Naturally, we were in conference most of the time while I was there.

Q. During the course of those conferences in Charleston after that meeting in Washington, tell the Court whether or not you were given any information as to any proceedings being brought?

A. The day after the meeting we left Washington and came to Charleston. One of the first things I heard the following morning was that proceedings were going to be taken by the—by the Auditor, Mr. Sims.

Q. That was court proceedings?

A. Well, I didn't know what the proceedings were. He [fol. 3332] was going to take steps to take the company; I presumed it was court proceedings.

The Court: He had notified the company of that before you ever went to Washington, though, hadn't he?

A. I heard rumors of it. I didn't know.

Q. This you heard after you came back from Washington was just a continuation of the rumor you heard before you went, wasn't it?

A. Well, yes, you might say it was revived. I know before we left to go to Washington a rumor came out that Mr. Sims was going to take steps. As to what those steps were to be, I didn't know, and then I heard that he was going to wait there till we went to Washington to see how the meeting turned out and since nothing conclusive was reached at the meeting, my understanding was that he was going to definitely take steps and he was not going to wait any longer.

Mr. Palmer:

Q. Reverting for a minute to the Washington meeting, was there brought up or discussed or did you know of any

possible idea of attempting to have Mr. Sims declare a moratorium on cash surrenders of the company?

A. Well, the S.E.C. did—it was their strongest opinion [fol. 3333] and they tried to get the admission from the company, it appeared to me, that the company was insolvent; they should stop paying cash surrender values. That was one of their great objections to going into the plan. In other words, it wasn't on the plan particularly, but they did object to continuing paying out cash surrender values when we were trying to go through with voluntary reorganization and have certain contract holders take a loss which would be more or less admitting the deficiency, and why pay out a hundred cents on the dollar to those who came in and asked for their cash today? That, in general, I think, covered the point.

Q. What, if anything, was suggested about the moratorium to be declared by Mr. Sims?

The Court: Mr. Palmer, I don't understand your term "moratorium" or how Mr. Sims could declare any moratorium.

Mr. Palmer: I don't either, your Honor. That is why I am asking the witness about it.

The Court: All right.

A. Well, there was some discussion as to whether they could declare a moratorium on the cash values for a period of time while this plan was being carried out——

The Court: Who could declare it?

[fol. 3334] A. That I couldn't learn. It was mentioned as to whether Mr. Sims could declare a moratorium without going into court—a temporary moratorium for a period of time. As to whether he could or not, I couldn't find out from anyone and no one seemed to state definitely what the steps would be or how. I didn't understand it myself.

Mr. Palmer:

Q. If a moratorium had been declared which lasted more than sixty days, would that be in violation of the terms of the contract?

A. Well, the contract, in my opinion, provides that the company must pay the cash value within sixty days from the application, or something to that effect.

The Court: It wouldn't be necessary, then, to have a moratorium during that sixty days?

A. No, but that goes back to the question as to how long it would take. In other words, the S.E.C. felt that no cash value should be paid. Then the argument arose as to whether the plan could be put into effect within sixty days.

Mr. Palmer:

Q. And was there a discussion had about whether it could be put into effect within sixty days?

A. There was various discussions pro and con.

[fol. 3335] The Court: With reference to this so-called moratorium, now, that wouldn't begin to be effective until the sixty-day period was up?

A. That is true because we were allowed sixty days in the contract at our option.

Mr. Palmer: And what, if anything, was *said as to* whether it would be an act of bankruptcy if at the end of sixty days anyone declared a moratorium and the company did not meet its obligations as set out in its contract?

A. There was some discussion in that regard as to whether it would be an act of bankruptcy or not, but I don't believe any conclusion was reached that I heard except there was a discussion as to whether that would be an act of bankruptcy.

Q. Was there a discussion as to whether or not within sixty days the company could put over its plan to the contract holders?

A. Yes, there was some discussion on that.

Mr. Palmer: Now, if your Honor please, it is in reference to that discussion that Mr. Pulfer took part in that I want to ask about that discussion. I didn't want to go back into it over the Court's ruling.

The Court: I permitted you to develop that there was [fol. 3336] a discussion but I will have to sustain an objection to any questions as to what the discussion was.

Mr. Palmer: All right, sir.

Q. Now, getting back again to the conferences in Charleston, did Mr. Tom Foulk come from Wheeling at any time to take part in those conferences?

A. I believe he was here on Saturday—Friday or Saturday following—well, he was here in Charleston the last day that we were all here.

Q. That would be the third or fourth of April or fifth?

A. I would say the fourth, approximately.

Q. Mr. Pulfer said something about your having a plan—he didn't say whether it was oral or written—which you gave the rough details of at that meeting. Would you tell us first whether it was an oral or written plan?

A. The only thing we had was a verbal discussion on a plan of reorganization by voluntary basis different from that which was presented in Washington.

Q. You say different from that?

A. Yes, but they were both voluntary is the reason I said that.

[fol. 3337] Q. Will you give us what your ideas were as you expressed them to the others?

A. Well, when they heard of the proceedings being taken or that they were about to be taken, they were trying to find out if it was some voluntary plan that could be used that may be practical to be put into effect in a short period of time; and the thought was in presenting some plan of that nature to the Commissioner or to the Auditor to see if he wouldn't hold off the proceedings against the company. Now, the plan that was presented in Washington provided a complete change of the contract, in addition to the contract holders agreeing to take a loss, and it didn't—the consensus of opinion of a number of individuals was that a plan of that nature could not be put into effect in the short period of time; so they were trying to find some working mechanics that might be; so the plan discussed mostly was a voluntary lien plan which would require no change in the present contract immediately, but those accepting the plan would agree to a voluntary lien placed against the contract. By a lien I mean the company's claim against the reserve on that contract, which, after putting into effect, would become and be treated in the same manner as any [fol. 3338] policy or any contract loan in use by the company.

Q. In other words, this lien is a little different from what we lawyers speak of as a lien. It is just the same as though the policyholder borrowed the amount of the lien, but the company doesn't give him any money, but calls it a policy loan and treats it as such except that the lien covers the

deficit by agreement of the policyholder instead of him getting money for his loan. Is that, in layman's language, about what it means?

A. Approximately. The lien is assumed to cover the deficiency and would bear interest in the same way as a contract loan and would be a claim against the contract.

Q. And it is an agreement voluntarily made by the contract holder to make up the deficit in his particular fund?

A. That is correct.

Mr. Jaegerman: That would bear interest to the contract holder, wouldn't it? The contract holder wouldn't have to pay interest to the company, would he?

A. The lien would increase as the result of the interest.

Q. But the contract holder wouldn't pay that interest? [fol. 3339] A. He wouldn't have to pay it in cash. It would be exactly the same as a contract loan except that it was intended that it should bear a different rate of interest, a rate of interest comparable to that on the reserve. If a person had a hundred dollars reserve and he was assuming a thirty per cent lien, actually he is reducing his equity to seventy dollars. However, since his contract has not been changed, his reserve remains at a hundred dollars. Therefore, he is charged interest on the thirty dollars that would offset interest that he is paying on the hundred while his equity is only seventy, and the effect is that he actually has an equity of only seventy dollars, while his contract calls for a hundred, but to keep from changing the contract, it continues to be a hundred. The interest charge on the loan is just offset on the over-statement of his lien over his equity.

Mr. Palmer:

Q. What was decided, Mr. Latta, at that conference as to whether that oral suggestion or idea of a plan could be put into prompt effect?

A. I don't know that there were any particular decisions except it was just felt—seemed to be the consensus of opinion that it could be put into effect much more readily [fol. 3340] than any plan previously discussed, although any decisions—I don't know of any decisions that were reached.

Mr. T. C. Townsend: It would take the consent of the contract holder to put it into effect, wouldn't it?

A. Yes. In other words, no contract holder had assumed a lien until he consented. It was a voluntary plan.

Mr. Palmer: And was it again the proposition that those who did not consent would be better off than those who did not consent?

Mr. Townsend: I object to that.

The Court: You say, "Was there again the proposition."

Mr. Palmer: No, the flaw.

Mr. Townsend: Read the question.

(The question was read.)

Mr. Palmer: I will say "flaw" instead of "proposition."

Mr. Ray: What right does he have to say it was a flaw?

Mr. Palmer: Were those who did not accept this plan to be offered to them better off than those who did accept it?

[fol. 3341] The Court: It is a legal conclusion, it seems to me.

Mr. Palmer: No, your Honor, it is a practical matter as the witness explained to the Court before; not a legal conclusion, but a mathematical calculation in the field where this man is an actuary.

The Court: Well, it certainly seems to the Court that if there were no corresponding changes in the plans for the ones who did accept it, and you say to one man, "We will give you a hundred per cent," and to another, "We will give you eighty-five per cent," that it is just obvious, without the need of any question, that the man who gets the hundred per cent gets more than the man who gets eighty-five per cent. I understand, however, that when the witness speaks of a plan, he means some sort of arrangement whereby the person that took the cut would get some corresponding advantage.

Mr. Palmer: That is what I was going to ask him, whether they would or would not.

Can you answer the Court's question, Mr. Latta, whether or not those who took the cut would get an advantage which those who did not take the cut would not get?

A. No, he wouldn't have any advantage the others [fol. 3342] wouldn't get.

Mr. T. C. Townsend: He would have a disadvantage, wouldn't he?

A. Well, the only difference between the two, one has taken a loss and the other has not. Outside of that, their contracts remain the same.

The Court: Mr. Latta, what is the difference between this plan you have talked about and the situation where there is a thousand dollars to be divided and fifteen hundred dollars of claims against it, and you go out and say to creditors that have the claims, "If you will all take a reduction amounting to two hundred dollars, we can distribute the thousand dollars, but if certain of you want to take a deduction and others don't, we will pay the ones that don't a hundred per cent and the others that do will get correspondingly less." Of course, such a plan as that would not appeal to anybody. I want to know, what is the difference between that sort of a plan and the plan you are talking about.

A. That is roughly the principle of the plan.

Q. Well, then, what hope did you have that anybody would ever sign it?

[fol. 3343] A. Well, the only hope that a voluntary plan might be put into effect is that a sufficient number of people representing large enough claims would contribute enough to cover the deficiency in order to keep the company going.

Q. What benefit is it to them to keep the company going?

A. Those people, probably the only reason they would agree to it, thinking that even after taking that cut they would be better off than if the company went into Court and was liquidated or some other proceedings taken.

Q. Is there any basis for that?

A. In this company I don't think there is the basis there is in an insurance company. In an insurance company there is definitely a basis for it.

Q. Was there a basis in the situation here?

A. Yes, there was some in the case of approximately half the contract holders, half the contract holders having insurance-protected contracts. Out of those, a number of them could not—although they were eligible for insurance at the time these contracts were issued, but at the present time they may be uninsurable. They had insurance protection which might have been carried on.

[fol. 3344] Q. Wasn't there also an advantage to the ones who signed such a plan that their contracts would be continued and that the rate of cash values in those contracts would increase in the future at a higher percentage than it had increased in the past, so that they would then get the benefit if their contracts were carried to conclusion of some large deductions that had been made from payments in the beginning with corresponding smaller deductions made towards the end of the payment of the contract? Wasn't there that advantage?

A. No, I don't think there was any difference in the deduction to be made or any deduction in the interest that they would receive.

Q. I don't mean to say that the contracts would be changed in that respect, but it has been developed that in the case of these contracts, their cash values during their earlier years are comparatively small and that during their later years, their cash values increase much more rapidly than they do in the early years. Doesn't that furnish some incentive to a contract holder to want his contract to go ahead to completion rather than take the cash value now?

[fol. 3345] A. Why, yes, because if they quit now and still want to continue making payments on the contract—or some new contract—they could not at the present time go out and buy a contract that would pay them as high an interest payment. Then in addition to that, when you buy a new contract, you have a certain amount of loading that must be paid in the earlier part of the contract, that is, presumably, the first year. After approximately the first year, I can't say that there would be any difference in the amount of increase in proportion to the payment made.

Q. Wasn't it that element in the situation that was counted on to persuade these contract holders to sign up to take their loss?

A. I think that is true in any reorganization. That is one of the purposes of reorganization.

Q. That was the offset the man got who had to take his loss of fifteen per cent?

A. Yes, sir.

Q. He got that offset to recompense him for the amount of cash, not getting a hundred cents on the dollar?

A. That is correct.

Mr. Palmer:

Q. Mr. Latta, I am not certain, in view of the Court's [fol. 3346] last statement that the Court fully understands the entire proposition. The man who doesn't accept the plan didn't cash in; he went right along and paid, but he had a contract that called for a hundred cents on the dollar. Isn't that right?

A. Why, yes, they would both be able to continue their contract. One takes a loss and the other doesn't. That is the only difference between the two contract holders. But, I understood the Court's question more or less to be the advantage of—or why a person would agree to accept a loss.

Q. Persons who had only been carrying the policies for a few years would have a distinct advantage in taking the loss and going ahead as the Court has suggested so that they could in time have their cash surrender value equal the amount paid in, whereas perhaps a person who had been carrying his contract for seven or eight years wouldn't have that same impelling motive on that. That was the Court's suggestion. Do you agree with that?

A. I think that is true.

Q. So that there were some advantages to be gained by those who would accept the voluntary reduction as compared with those who did not?

[fol. 3347] A. I don't think that comparison can be made.

Q. You don't think that comparison can be made. Both were, however, under the plan expected to go on and continue their payments and maturing their contracts?

The Witness: Will you state that again or have it read?

(The question was read.)

A. There was no difference in the two whether one accepted or the other did not, except that the lien assumed by a certain number would be used to cover the deficiency. That is the only difference between the two that I can see.

Q. In your experience have you known of life insurance companies where a similar proposition to this was offered where anyone who desired could take a voluntary reduction or have a lien placed againt their policy and those who didn't want to didn't do it and whether that company went on and then was able to operate after that was done—one or more companies that did that, and mention their names, please?

A. Well there are two companies that I know of that used a voluntary lien plan very similar in nature. One of them was continued and is in business today. The other put the [fol. 3348] voluntary lien plans into effect and then was later reinsured with a company assuming the contracts with the liens against them.

The Court:

Q. Mr. Latta, do you think it is possible to get as equitable a result by that sort of plan which you call the voluntary lien plan in case two-thirds of the contract holders in certain classes want to do it and the other third don't want to do it—do you think it is possible to get as equitable a result in that way as it is by some plan where the other third is forced to comply with the wishes of the two-thirds?

A. Are you referring to the voluntary lien plan?

Q. Yes. I am asking you whether you think that voluntary lien plan produces as equitable result in cases where there are as much as two-thirds of the creditors or contract holders of a certain class that want to put it into effect as a plan, whereby the other third would be forced to comply and take its proportionate share of the loss, too?

A. I will answer that in this way: The voluntary lien plan, as far as my understanding of it being equitable, there is nothing equitable about a voluntary plan.

[fols. 3349-3363] The Court: That is what I thought.

The Witness: Because when a person accepts a voluntary lien plan, that is just an agreement between that individual and the company, while another case it is based on equal dollars and cents.

* * * * * * *

[fol. 3364] The Court: I will sustain that objection in that form. I will ask the witness this question, however, which I think will cover the situation, as I see it.

Q. Mr. Latta, is it possible to construct an actuarial plan of reorganization for Fidelity?

A. Yes.

Mr. Palmer:

Q. In your experience, Mr. Latta, would that actuarial plan work?

Mr. Ray: Oh, that is the same thing in another way, trying to get the witness to answer something the Court has ruled he is not qualified to answer.

The Court: Sustained.

Mr. Palmer: I will have to make an offer upon the record, your Honor.

[fol. 3365] The Court: All right.

Mr. Palmer: The witness, if permitted to answer the question, would state that it is unreasonable to expect a plan of reorganization can be effected for Fidelity. The witness would further say, if permitted by the Court so to testify, that Fidelity itself can never be reorganized as a going concern, either as a face amount certificate company or as a life insurance company. If the Court would permit, I would like the witness to be permitted to state his reasons why Fidelity can never be reorganized and operated as a face amount certificate company and as a life insurance company, those reasons being based upon his experience and actuarial knowledge. I ask the Court's permission for that.

Mr. Huwe: Your Honor, I move that the proffer be stricken from the record for the simple reason that all of Mr. Palmer's statement precludes any company other than a face amount certificate company or an insurance company, and there are possibilities beyond those two categories in which the Debtor could be reorganized, and therefore any statements in any proffers limited to those two fields are not proper.

Mr. Palmer: Will you inform me the other possibilities, [fol. 3366] please?

The Court: There is no use to argue that. All Mr. Palmer has done is to say on the record that he believes this witness would make certain answers if he asked him certain questions. Those answers may be that the earth is flat when as a matter of fact we know it is round, but if that has bearing on the case, and this witness's answer might have some arguable basis for being received, I feel that I would have to permit that to go on the record; so, regardless of what the facts may be, I am going to permit Mr. Palmer to make his proffer.

Now, he asked to be permitted to ask the witness a question, and as I ruled before, I will permit any questions to be addressed to this witness's knowledge of actuarial

figures and plans, and if you will form your question, I will determine it.

Mr. Palmer:

Q. Mr. Latta, can you give, from your actuarial experience, reasons why Fidelity can never be rehabilitated itself into a going life insurance company?

Mr. Ray: Your Honor, that is putting into the record just exactly what you have excluded—an opinion of this witness.

The Court: He said a while ago in answer to a question [fol. 3367] that I directed to him that it was possible to prepare a plan of reorganization for Fidelity from an actuarial viewpoint, having stated that any opinion as to whether or not this plan would work would involve qualifications which he has said he does not possess, and so I will sustain the objection to the question.

Mr. Farmer: If the Court please, I would just like to call the Court's attention to this: That this witness who is now being asked these questions is a man who is brought here by Fidelity and entered its employ about the first of this year for that very purpose, as I understand it, of trying to assist in working out a plan, and he remained in the employ of Fidelity until it went into receivership; he remained in the employ of the receivers and remained in the employ of the Trustee until September 15th of this year; and if there is anyone who, from experience and study, especially the study of this company, and his borad training that he has had elsewhere and experience in other reorganizations, who is qualified to assist the Court in this way, it seems to me that this is the man.

The Court: You attorneys are undertaking to establish this witness's qualification simply by the statements that you are making to the Court. It happens that the answers [fol. 3368] that he has made have shown that his knowledge is confined to mathematical figures and until that is changed in some way by the witness's statements, I cannot go any further.

Mr. Palmer:

Q. Mr. Latta, is your knowledge of Fidelity and the possibilities of its rehabilitation confined wholly to mathematical figures?

Mr. Ray: He testified about that fully yesterday.
The Court: Let's see what he says now.

A. That depends largely on what you mean by mathematical figures. I don't know that any two people can have the same opinion exactly of what it means by mathematical figures. Figures mean nothing except an expression. It is a means of computing and determining the quality of two expressions. In making a contract, we don't do it by just formulas, exactly. I still stick to my statement yesterday as to the actuarial phase of it; I am not trying to change that, nor do I care as to whether I answer the questions asked.

Mr. Palmer:

Q. The actuarial field includes more than mere figures addition and subtraction?

A. The subject of actuarial mathematics covers all phases of operating a life insurance company.

The Court: You mean covers selling——
[fol. 3369] The Witness: I was going to add that, with the exception of actual selling in the field.

Mr. Palmer:

Q. With the exception of selling in the field, it covers all phases of what—?

A. All phases of operating a life insurance company—and the making of investments, naturally it wouldn't—the interpretation of effects and results of selling or the results of the investments comes under the actuarial phase of it.

The Court: That gets us to this point in this witness's testimony. He says an actuarial plan can be developed for the reorganization of Fidelity. He says he knows nothing about the selling. When we put those two answers side by side, it strikes me that the witness can't be permitted to go ahead now and say that he has certain opinions about the success or failure when he has already said that a plan can be developed and he knows nothing about the selling end of it.

Mr. Palmer: If your Honor please, I am afraid the Court is not quite quoting the witness exactly. He said he knows nothing about selling in the field but he did know

the effects of selling. That is, he knows the effects from an operating viewpoint of selling, but does not go int [fol. 3370] the field and sell.

The Court: I don't know what he means when he says he knows the effects of selling.

Mr. Palmer:

Q. Will you tell the Court what you mean by that, Mr. Latta?

A. By selling in the field, I mean supervision of their agents and their sales talk. However, the appeal of the contract and the contents of the contract must be worked out as much by the actuary as it is by the sales manager or someone connected with the sales, because the sales manager knows nothing about the operations of the contract and whether it is profitable, sound, or otherwise, any more than the actuary knows about the selling. Now, in the reorganization plan, I know that in past cases where we have been called in that naturally we have been—worked on—the first thing we do, as a rule, is make a survey to see the possibility of making out a complete plan of reorganization which covers all phases of it except the manner in which to contact the contract holders. I don't know that you can define the discrimination where one cuts off and the other starts. I have never been able to do it in the past. I surely can't explain where one cuts off and the other starts.

[fol. 3371] Q. With reference to Fidelity, have you conferred with Mr. Pulfer, one of the selling heads, concerning the salability of Fidelity in any rehabilitated form?

Mr. Ray: I am going to object to that, your Honor, because he has already testified as to his familiarity with the selling phases.

The Court: Mr. Pulfer has been a witness in this case and as I recall, he said that in his opinion reorganization could be effected and the contracts sold to the public. I am not certain that he said it unqualifiedly, but if so, and this witness has conferred with him, then we would have to say that he got that information from Mr. Pulfer. Then if he would answer contrary to that information, certainly his conference with Mr. Pulfer couldn't have anything to do with his opinion. I will sustain the objection.

Mr. Palmer: I will make an offer into the record that the witness did confer with Mr. Pulfer, one of the selling persons of Fidelity, and as a result of such, he became familiar with the selling end of Fidelity, both as a going concern and with reference to possibility of rehabilitation thereof.

Mr. Ray: Show an objection to counsel vouching the record as to what he believes the witness would say in [fol. 3372] answer to questions when the material put in the record flatly contradicts what the witness has heretofore said on direct examination.

The Court: Overruled as to the last objection.

Mr. Palmer: I ask that the remarks of counsel in that regard be stricken from the record.

The Court: No, I think there is some basis for that.

Mr. Palmer:

Q. Mr. Latta, will you please explain your answer to the Court's question when he asked you if Fidelity could be reorganized actuarially—I don't know the exact question, but you answered the Court's question "Yes." Would you explain your answer, please?

A. Actuarially whether it could be reorganized strictly from a mathematical viewpoint, as I interpreted his question to be, would be as to whether there could be computed, as far as figures are concerned, in order to place this company in a solvent condition, ready for operation on a sound financial basis as of that time. That is my interpretation of what he meant.

Q. Would it be possible to answer the Court's question by saying, "We will take from each contract holder forty per cent or place a forty-per cent lien upon each contract holder," work that out actuarially, and then you would [fols. 3373-3376] have the company reconstructed actuarially upon a sound basic? Would that be possible?

Mr. Huwe: I object to that question.

The Court: Overruled.

A. It would make the company solvent, but it wouldn't be reorganized on a sound basis, no.

Mr. Palmer: Beg your pardon?

A. It would be solvent at the time provided the forty per cent was sufficient. You could make the company sol-

vent, but that doesn't make it sound from an operating viewpoint, actuarially or otherwise.

Q. What would you do to do that?

A. Well, as far as a plan of reorganization was concerned, you would have to make the entire construction of the company so that the future operations could be done on a sound basis—could be carried on on a sound basis. By a sound basis, I mean as far as being able to meet the obligations when they may become due as specified in the contract.

* * * * * * *

[fol. 3377] Mr. Palmer:

Q. In other words, whether or not you could possibly construct an actuarial plan for Fidelity and your answer to that bears no relation to what your answer would be as to whether Fidelity could be successfully rehabilitated, is that correct?

A. They are entirely separate questions.

Q. And bear no relation to each other?

A. No.

Mr. Palmer: Then we will, if the Court will pardon us, ask that the Court's question and answer be stricken.

The Court: No, that is the phase of it that this witness has qualified himself to speak on. I have permitted you to develop that that phase has nothing to do with whether the company could successfully operate. I never thought in the beginning that it had anything to do with that, but nevertheless it is the phase that this witness is familiar with and the one on which his help to the Court may be of some value.

Mr. Palmer: If your Honor please, I think I see our difficulty. The Court has assumed that an actuary of actuarial [fol. 3378] experience is one who deals only with building up a mortality or actuarial table, whereas I think the true situation is the actuary is one who is familiar with every detail of the life insurance business. In other words, he is the general manager of the life insurance business, knowing every one of the branches of it.

The Court: This witness has not said that.

Mr. Palmer: I thought he did say it.

Mr. T. C. Townsend: You are thinking about Steussy.

Mr. Palmer: Mr. Latta, how far wrong am I in my state-

ment with reference to what an actuary is with reference to a life insurance company?

The Court: I don't like to give the witness that kind of question, how far wrong are you. I want him to tell me——

Mr. Palmer: Tell us, Mr. Latta, in detail as much as you can, what an actuary does and knows about the life insurance business.

The Court: What do you know about Fidelity is what I want to know.

Mr. Palmer: I would like to know about Fidelity and the life insurance business, your Honor. There isn't any such [fol. 3379] animal as I know it as an actuary of Fidelity, because Fidelity, if I may say so, is a monstrosity of which there are only one or two in existence and bear only a slight semblance of resemblance to other financial institutions. This gentleman comes qualified as a life insurance actuary. Whether or not his experience in that field will help in Fidelity we can investigate, but first I want to find out what is his experience in the life insurance field. That is his field and deep sea diving for Fidelity has been something of a side experience.

The Court: As to his qualifications, they are going to depend here on what he has been able to learn and know about Fidelity and not what he knows about life insurance actuarial practices in general.

Mr. Palmer: Can we first show what an actuary of a life insurance company does and knows to show this man's general background and qualifications?

The Court: Well, if he can make it any more definite than he already has. I thought he covered it.

The Witness: I think I answered that question a while ago that you can't draw a line where a phase of it cuts off and other phase of the business starts, and I also said——

[fol. 3380] Mr. Palmer: Does an actuary have anything to do with building up the life insurance policies—the terms of them—not the figures, but the conditions and terms?

A. As a rule, I believe most life insurance contracts are drawn by the actuaries in collaboration with an attorney for the legal phases and interpretation.

Q. What, if anything, does the actuary have to do with reference to discovering whether the policy he draws up is salable or not before he draws it up?

A. He has to work with the sales manager somewhat in the same manner that he worked with the attorney, as far as the actual drafting of the contract.

Q. Now, what does he have to do with reference to finding out the operating cost, whether the company could make money on selling that particular policy?

A. Well, that is for him—that is his job to determine. In life insurance work, the actuary is usually in the same category as a certified public—an accountant, I should say, would be with some other company. In other words, they deal with the operations, the causes and effects of the profits [fols. 3381-3391] and losses to be made as a result of changes in operation or whatever may be done—any phase of the operations.

Q. Does he have to know the various operating expenses, as well as operating income in order to be able to carry on his job properly?

A. Well, yes, that deals with the operations.

Q. And he has to realize how much income will come in from a policy and what the operations and overhead of the company will be — reference to it, is that correct?

A. That is correct.

* * * * * * *

[fol. 3392] The Court: If this witness is asked what it is necessary to do in order to convert Fidelity into a going life insurance company, I will permit him to answer that question and then we will leave it for the Court to decide or for some qualified person to give his opinion as to whether or not on the doing of those things a successful plan of reorganization would have been effected.

Mr. Palmer: All right. Can you give us your answer, [fol. 3393] Mr. Latta, to the Court's suggestion?

The Witness: May I have the Court's question read?

The Court: I didn't ask him a question.

Mr. Palmer: I meant, give us your ideas as to the Court's suggestion what you would be permitted to testify.

Mr. Ray: Your Honor, I think that is practically the question which Mr. Palmer asked immediately upon resumption of the hearing and the witness said he couldn't do it; that there would be infinite——

The Court: You may be right about that, but if he can do it, I am willing to permit him to do it.

Mr. Palmer: Will the reporter read the Court's suggestion to the witness?

(The statement by the Court which Mr. Palmer referred to was read.)

A. I could name some of the main problems.

Q. All right, sir. Will you do that, please?

A. But as to whether it covers the situation, I don't suppose it will. One is that it must be determined the amount of equity that a contract holder would be allowed to be applied toward any adjusted contract. One of the main problems is determining the new contracts—con- [fol. 3394] structing the new contracts that are going to be offered to the present contract holders and as well to any prospects that may be contacted. Another problem would be for the company, after reorganized and after established, to obtain a license in each state in which the converted contracts are to be sold or whereby new business may be sold. Another problem would be to determine in each individual case as to how the equities which he received as determined by the Court or otherwise may be applied toward such new contract as accepted by the contract holder. It would be necessary to determine some method whereby those contract holders not accepting any of the contracts—the new contracts offered by the insurance company—as to how he may receive his equity. And of course it would be necessary to set out your entire operating plans of your new company, the basis from an operating standpoint—I might say that phase of it would have to be considered the same as if you were organizing a new company of any kind.

Q. Mr. Latta, did you tell us yesterday you had taken part in the reorganization of fifteen life insurance companies?

Mr. T. C. Townsend: He has asked that. Everybody [fol. 3395] knows that he did say that.

Mr. Palmer: All right, then.

Q. Then, Mr. Latta, can you tell us whether or not as an actuary these problems that you have suggested can in some part be solved by an actuary?

A. I don't know what you mean by solved. I would have to qualify that. I can qualify it by meaning what the effects and causes would be, but the degree of what the results may be, that is another question.

Q. What part did actuaries take in the attempted reorganizations of the companies with which you worked?

Mr. Ray: Your Honor, that is certainly irrelevant. He has gone into what actuaries do over and over again and I think he has testified as to what part he had in those reorganizations.

The Court: I think so too, but at the risk of repetition, I will overrule the objection.

Mr. Ray: He definitely said he supervised the actuarial work in those reorganizations. That was his exact language.

The Court: Well, now, I understand, Mr. Palmer wants to know what that actuarial work was that he supervised. [fol. 3396] Mr. Palmer: That is right, your Honor.

A. To give a definite answer to that—it is rather a broad scope—I will go back to my answer previously that as far as the reorganization covering the points I mentioned a while ago, it would cover those phases with the exception of the contacting in the field and making the sales of the conversions or the handling of the securities.

Mr. Palmer:

Q. And with the exception of the legal determination of the equities—it would not include that feature. By that I mean that the actuary could figure out percentages or proportions if some legal body would lay down the rules of law by which he should be guided? Is that correct?

A. Well, I think the actuary's work all the way through is necessarily guided by laws and rules laid down wherever the legality comes in.

Mr. Palmer: Now, if your Honor please, with those answers of the witness, I think the witness should be permitted to testify as to the method of solution with Fidelity of the problems which the witness has indicated.

The Court: You mean ask his opinions about that?

Mr. Palmer: Yes, sir, as to how that should be done. [fol. 3397] The Court: I sustain the objection. This witness testified a while ago in answer to the Court's question that he took all those phases that he enumerated of the actuary's contacts with the different elements in a plan that might be set up—he took all of them into consideration when he answered my question that from an actuarial stand-

point a plan of reorganization could be framed. Now, that is, in my opinion, as far as this witness can go. He can't go beyond the actuarial phases of it.

Mr. Palmer: Still, if your Honor please, the Court has not permitted him to state whether or not from his experience as an actuary if he would do all that whether it would do any good and that is the point we are interested in.

The Court: We are just as qualified to form an opinion on that as this witness is so far as he has shown.

Mr. Palmer: How many of us have been in the reorganization of fifteen life insurance companies, if your Honor please, where we have had those problems and worked them out to see if they would be successful?

The Court: Well, I will have to sustain an objection to his opinion.

[fol. 3398] Mr. Palmer: Let the record show that if the witness were permitted to testify——

Mr. Ray: I object to this, your Honor. He is going to vouch an opinion which your Honor said he couldn't do.

The Court: No, I said he could vouch this witness's opinion all he wishes, but he is not permitted to vouch any facts in the record that the witness would testify to without first asking the questions about those facts and having it ruled on. You may state in the record, Mr. Palmer, whatever you wish as to his opinion.

Mr. Palmer: May I ask the Court's further protection also, since I can't get the courtesy from counsel, when I am addressing myself to the Court that counsel be instructed by the Court to wait until I have concluded my statement before they interrupt with the objection?

Mr. Ray: I am sure we would not have been interrupting if counsel at this end of the table didn't think you had made so many broad statements that shouldn't go into the record.

The Court: I will admonish counsel not to interrupt, because if the Court feels that anything of an improper nature is being said, the Court will do the interrupting.

[fols. 3399-3418] Mr. Palmer: Thank you.

Will you read what I said?

(Mr. Palmer's statement was read as follows: "Let the record show that if the witness were permitted to testify"—)

Mr. Palmer: (Continuing.) Counsel believes that the witness would say that it is possible in his opinion that as

to each contract of Fidelity, the equities can be, when the rules for determining the equities have been first laid down by a proper judicial tribunal, exactly determined and thereupon applied to each contract and that that contract can be revised as to actuarial set-up so that that particular contract can be liquidated, either immediately or slowly from the assets of the company.

. . . . . .

[fol. 3419] The Court: It would make a difference, wouldn't it, whether the securities were being managed rather than being just left where they are?

A. That is right. In the calculations in computing and determining a contract you are going on one theory of all life insurance companies, and I think it applies the same to a face amount certificate company, because the factors involved are identically of this nature. You are assuming [fol. 3420] that the company is operating as a perpetuity. For instance, you are not trying to determine when a security will mature, when it will be paid off, when it may or may be sold, and if sold, that the money received shall be reinvested. You are also assuming if in one case you are having new money coming in from one contract, that identical dollar, whatever way it is invested, has no practical relationhip to the contract in question. For instance, we have $10,000 here; we are talking about an isolated amount; that $10,000 doesn't apply to any particular contract, but applies to all of them alike. Whether one contract matures, it doesn't make any difference in your assumption whether that money is from premiums, income just received, or whether it liquidated a security. In the valuation of securities as used by life insurance companies it is considered on a long term basis. That is one reason they do not use market values. In making a valuation of the solvency of a company they are not considering as to whether that contract will be sold today, because they have assumed that all of these policies are not going to be cash surrendered today, or they are [fols. 3421-3423] not going to be matured today. That is where your large number comes in again; it is operating as a perpetuity, assuming the same number of contracts in force whether one begins today and the other matures today, that goes back to the theory of a perpetuity in large numbers. That annuity, if you are going to determine just

how much they had, that they had $10,000, like you said, or $500 apiece. Now, there is no consideration to cover operating expenses. That would have to be taken into consideration.

. . . . . .

[fol. 3424] Mr. Palmer:

Q. Suppose that today it would be decided to determine the proportion of the entire company that each contract holder was entitled to, that one would be entitled 1.52/80,000 and so forth of the company. In other words, there has been made a determination. Now, there is to be no new contract sold, no new payments paid in, but at the end of 10 years the fund is to be paid in its entirety to the contract holders at the end of that period of time, and during that time the securities are to be managed properly by a competent person to keep them so that they will return the greatest amount that can reasonably be expected when liquidated into cash. Now, what other factors in the way [fol. 3425] of operating expenses, in the way of the number of contract holders getting less and less each year, would be encountered in such an idea?

Mr. Ray: Your Honor, what is the pertinency of such an idea?

The Court: Well, I will overrule the objection to that.

A. I can't see where—exactly what is meant by it, except that the assumption is—Let me interpret your question and ask whether this is a correct interpretation or not. Do you mean what would have to be considered in order to liquidate this over a period of ten years?

Q. That is right.

A. That goes back to the liquidation again of a fixed amount. Now, as to being able to determine if a person had an equity of 85 cents today, to determine what he could get, then you have a large number of factors there that are speculative.

Q. Well, what are those factors?

A. Well, you don't know what those assets are going to liquidate for, even though you determine the market value [fol. 3426] today, then you are going into the speculation of what these securities bring over a period of ten years liquidating them 1/10th a year. Who knows which securi-

ties are going to be liquidated? Putting them in the form of statistics, you are getting away from the perpetuity entirely, and you must liquidate possibly 10 per cent each year. Now, whether the next three years they would liquidate correspondingly to the value as to what they would bring today has no relation to what the securities you are going to liquidate four years from now, except through speculation. You don't know whether they are going to be up or down or what the securities the individual decides to sell, or whether he sells the security today even at a loss compared to the value placed on that today. That is the one large speculation. Another is the interest factor, another is the expenses. You can't estimate what the expenses are going to be unless you know the nature of your setup. Just before, when I was talking about going into the expense of a reorganization plan, or what the company may be, you are assuming as a going life insurance company what the expenses are going to be accord-
[fol. 3427] ing to the average or according to what can be expected. Now, as to what they are going to be, you don't know. When you are talking about a reorganized company you don't even know what the management is going to be, you don't know what the setup is going to be, you don't know what kind of people they are going to have. That goes back to taking the individual case and applying it to the general rule. You can't apply anything to this company, because as soon as you apply to the background of the company statistics do not apply. As soon as you change your basic information, it is like saying, "What can the profits be on this as a life insurance company as compared to a face amount company?

The Court: Isn't there a short answer to what Mr. Palmer asks you, that actuarial calculations are never made on a liquidation basis?

A. That is correct.

Mr. Palmer: You spoke about expenses. As the number of contract holders decreased in the assumed case I have given you, the expenses per person must go up? Isn't that true—or is it true?

A. Well, in general, if you have a fixed company, we
[fol. 3428] have a company operating——

Q. No, forget that, please, sir, and stick to my question.

A. I have to make some assumptions. Maybe I misinterpreted your question.

Q. Taking Fidelity today, taking the assets of it, and we are going to finish up with them in ten years we are going to pay off the contract holders as we go along during that period of ten years, now, as the number of contract holders gets smaller, isn't it true that the expense per person left in the group will be high?

A. You are going back to the same statement we made a while ago in making a statement as to what the expenses are going to be operating under a given plan. You are assuming you know what they are going to be.

Q. Will your expenses be higher or lower per person?

A. You are not operating?

Q. That is right.

A. We just stated a while ago that in making computations from statistical data you are not figuring on a liquidating plan.

Q. Well, figure on this liquidating plan. That is what [fol. 3429] I want you to do.

A. I can only assume by comparisons with a life insurance company or even Fidelity.

Q. All right.

A. If you take the same company with a hundred thousand contract holders, and whether those, through forced liquidation, voluntary liquidation or just natural liquidation—that is, by natural liquidation I mean where the sales of new contracts are less than the maturing contracts of those who carried their contracts in—in other words, the normal operation of the business is decreasing as far as the number of contracts in force, yet a number of your expenses are fixed, such as the cost of the home office, such as managerial fees, in some cases, if it depreciated sufficiently, your expenses are coming down.

The Court: Are you talking about an operating company or liquidating.

A. Liquidating, whether it is voluntary or otherwise.

Q. Why do you think it is necessary to have a home office in case of liquidation?

[fol. 3430] A. Well, I said that I could only compare it to that, because we don't know under what conditions the company would be liquidated. That is to be determined. That is the reason I said I couldn't state a factor there.

The Court: Go ahead. I didn't mean to interrupt.

The Witness: That is all right.

Mr. Palmer:

Q. So that, as I gather it, your answer would be that the expenses, as the group grows smaller, are necessarily higher in proportion per individual in the group?

A. As a rule I think that would apply, because fixed expenses remain the same regardless of the number involved.

Q. When you take a large enough group, you can apply your totals based on past experience to that group, and you so do in your business? Isn't that true?

A. Yes, we apply it and then we compare the actual experience with what we have estimated.

Q. You would not, however, attempt to take one individual of that group and say, "These general rules should apply to that individual"?

A. When you are working on individual cases you ap-
[fol. 3431] ply the general rule, yes.

Q. As you come gradually down, where you get a smaller and smaller group, is it true that you come further and further from your general rule of averages?

A. That is true; the smaller your sample the larger your fluctuation from that which you predicted or expected.

Q. So that if you assumed at the beginning a given rate of interest, as your group got down lower and lower the possibilities of your assumption varying would be greater and greater. Is that correct?

A. That doesn't necessarily apply. I think it does to some extent, but the degree, as far as the interest on investments is concerned, it goes back to this, if you have two securities, one of them earning interest and the other is not, naturally only 50 per cent is earning interest, whereas if you had a large group you could still isolate them and pick them out where only half of them are earning interest. Large portfolios usually vary to a less degree because they are more or less constant. Again, you are getting away from liquidating.

[fol. 3432] Q. Now, Mr. Latta, with reference to forming Fidelity into a going life insurance company, one of the problems that you would have—one of the problems, I say,

—would be this question of the liquidation, slowly or rapidly, of some of those contract holders. Isn't that true?

A. That would be a question to be considered, and it would be different in each case of reorganization contemplated or each plan that would be contemplated.

Q. I say, in converting Fidelity into a life insurance company, you are going to have to have some of those contracts liquidated either immediately or slowly by virtue of this annuity plan or some analogous plan? Isn't that correct?

A. Yes, if you are going to liquidate over practically the limit of time involved in one contract, ten or eleven years, that is the life of them, therefore all of the contracts that are there now, assuming the practical question or the theoretical question, either mature or begin to mature within a period of ten years.

Q. Now, considering that you would take none of the assets of this company away from those former contract [fols. 3433-3437] holders, then the only way that you would have to get operating expenses under the new life insurance company to manage this voluntary or slow liquidation would be by virtue of the money you would get from new premiums? Isn't that true?

A. Yes, I would say that was true, unless you took it from the equity that was there now.

Q. I said, leave that equity there.

A. Oh, I didn't understand it.

Q. So, in other words, if you would turn Fidelity into a life insurance company and want to give each contract holder the equity that he now has, it would be necessary for new policy holders to pay for the liquidation of the old ones? Isn't that the substance of it?

A. Well, of course you are assuming that you are going to give it out to them in a fixed manner?

. . . . . .

[fol. 3438] Q. Now, Mr. Latta, with reference to converting Fidelity into a going life insurance company, there would be a certain percentage who would be insurable—that is true, is it not?

A. Yes.

Q. And there would be a certain percentage of those who would take out insurance. That is true, is it not?

A. I would imagine that would be true.

Q. That would necessarily consist of an agreement between them and the new company for a conversion of their equity in their old Fidelity contract into a new life insurance policy. That is true, is it not?

A. I believe that would be true.

Q. As to the balance of the group who either were not insurable or who were not inclined to take insurance, there would have to be some means of liquidating their equities in their Fidelity contracts. That is true, is it not?

A. That would depend on what you mean by liquidating.

Q. There would have to be some way of giving them money in exchange for their equities.

[fol. 3439] A. Naturally if you are going to give them their equity they have to have some means of receiving it.

Q. That is right. One way would be to sell the securities or assets which back up their equity and turn [illegible] over to them in cash. That is true, isn't it?

A. That is one way. That is liquidating the equity, I would call it.

Q. Another way would be the hypothetical way we discussed earlier of giving it to them over a ten year period. Isn't that true?

A. Yes, roughly.

Q. Sir?

A. Roughly, I would say.

Q. I want you to give me other ways which you would have of converting their equity into and returning cash to them?

A. Well, there would be a number of ways, but they would all range between a case of immediate liquidation and paying the equities as soon as the assets could be liquidated, and offering them in some form of annuity or some method of payment over a period of time, or to operate the fund [fol. 3440] or those assets over a period of time and then having a deferred liquidation.

Q. In other words, it would either be immediate liquidation, and by that we are speaking of selling the as-ets and converting them into cash and distributing that, or deferring that to a later period, or giving them some form of annuity or a combination, or giving them an immediate cash liquidation plus annuities and later deferred liquidation? Is that correct?

A. It could be any degrees, yes—any number of degrees.

Q. But those are the basic principles?

A. I would say yes, because annuities is a broad term.

The Court: It could be fixing the amount of their equity on a percentage basis and then just letting their contracts that they now hole mature, couldn't it?

A. That is true.

Mr. Palmer:

Q. And each of those would involve the various items of expenses that you have heretofore discussed?

A. Naturally you can't manage it and handle it without having expense, if that is what you mean.

[fols. 3441-3468] Q. And be subject to the risks of depreciation and appreciation that you have discussed?

A. I covered two or three elements a while ago.

Q. With reference to reforming Fidelity as a going life insurance company, it is true, is it not, that that part of the company which would operate to sell new life insurance and set up reserves on it would be, in effect, beginning as a new life insurance company, starting from scratch? Isn't that true?

A. Oh, they have no life insurance now, and the only way I can see would be starting one from scratch.

Q. There would have to be a capital structure or fund set up to begin with, wouldn't there?

A. In some way, otherwise you can't obtain a license to sell.

. . . . . .

[fol. 3469] Mr. Palmer: If your Honor please, I ask that the testimony of Mr. John Marshall on his direct examination, Volume I, pages 429 and 430, to the effect that he thought a plan was feasible and that he never saw anyone who had ever made a study of the situation in our organization who did not feel that it was feasible and that he knew that that was the position of Mr. Arthur Koontz all these years—I ask that that testimony be stricken out. I further ask that the testimony of Mr. Pulfer, Volume II, page 788, as to the feasibility of a plan of reorganization, be stricken. I ask that the testimony of Mr. Messick, Volume II, pages 889-890, be stricken. I ask that the testimony of

[fols. 3470-3477] Mr. Young, also introduced by the debtor, Volume III, page 1423-7, as to the feasibility of the plan, your Honor, stating their opinion be stricken from the record.

The Court: Overruled.

* * * * * * *

[fol. 3478] Cross-examination.

By Mr. Farmer:

Q. Mr. Latta, who employed you, that is, what officer of the Fidelity company, to come down to Wheeling the first of January and do this work which you did?

[fol. 3479] A. I wasn't employed by Fidelity until February 12th.

Q. All right; February 12th.

A. As to whom I was employed by, I can't say. I was so informed—rather I had interviews with various officers, and my understanding was that they took that into consideration, and I was informed after tentative arrangements were made that it must be approved by the executive committee——

Q. Who were those officers that told you what the nature of your work was to be—your duties?

A. Well, the nature of it in general—general consensus was that I was to be an actuary and underwriter for the time being.

The Court: He said who told you that?

A. Well, the tentative discussions were made with Mr. Messick.

Mr. Farmer:

Q. Mr. Messick?

A. He was the first gentleman to contact me; he was the first officer.

Q. Did he tell you that the company was in financial distress and he wanted you to go down and see if you could [fols. 3480-3484] work out some plan of keeping it off the rocks, or words to that effect?

A. No, he didn't say that.

Q. No, not those exact words—what did he tell you, then?

A. Well, his inference was essentially this, that the com-

pany could no longer operate in accordance with the laws as a face amount company in the manner that it had in the past, and they as a group—I don't know who he meant by "they"—had exhausted their possibility and made a complete study of the matter and had decided that they wanted to reorganize the Fidelity Investment company as an insurance company, and since they had to change their methods of operations that they believed that the nature was similar and their best future would be based upon reorganizing as an insurance company, and they had contemplated a reorganization program by which, through some method, they could convert this into an insurance company, and that was the reason they were interested in having me come with the company—that was the basis of the whole conference.

. . . . . .

[fol. 3485] Q. If you have an insolvent company, of course, it is axiomatic that there are just two ways of obtaining a condition of solvency, either by increasing the assets from a source outside the company, or by effecting a reduction of the liabilities of the company so that the liabilities will correspond to the assets?

A. That is correct.

Q. Now then, what amount did you calculate, that is, in dollars and cents, that reduction of 15 per cent in the uni-[fol. 3486] form plan would be—roughly; I am not asking you to give it to me in dollars and cents.

A. Roughly it would be three and one-half million dollars.

Q. Did you and the other officers who worked on it, in suggesting this 15 per cent reduction, arrive at that percentage of reduction for the purpose of obtaining that given sum of three and one-half million, or how did you happen to take the 15 per cent?

A. Well, I think 15 per cent is set out in the plan—If you notice, you have two plans there; they are each different; and if you made five others—but in each case various factors were involved in determining which one would be given in typewritten form.

Q. Well, in each of them were you seeking to obtain the result of the release of about three and one-half million of liabilities?

A. Naturally we would have had approximately that amount, which, in accordance with the valuation of the assets as given in that exhibit, it would require that amount

in order to make the company solvent and establish it as a going concern.

[fol. 3487] Q. Your plans were formulated with a view of obtaining that goal—that end—is that right?

A. That was one of the purposes.

Q. One of the purposes?

A. Yes, sir. Now, for instance you made the statement as to what the purpose of the plan was there, and you read in substance. If you will note, it called for a transfer of both the assets and liabilities of the fund to the general fund. You also made an inference in that connection, that it was for the purpose of establishing a surplus in the general fund. Well, that is not true. The purpose of transferring it to the general fund was not necessarily to create a surplus to the general fund, which belonged more or less to the stockholders, but the income funds, for instance, the special income, had a deficiency which had no direct relationship with the 15 per cent, and the same way with each of the other funds. Whatever method of valuation you used, each fund would have a different degree of solvency. Therefore the only way that a uniform plan would mean anything in order to reduce the liabilities on a uniform basis, would be a consolidated plan whereby the results [fol. 3488] would be that all assets and liabilities would be consolidated. One of the purposes, primarily, would be to eliminate so many different funds, because of the great expense of operating those on a fund basis. In addition, each time you have a fund and you later decide to discontinue the issuance of those contracts, where there is no new contract holders belonging to that fund, then immediately that fund becomes upon a voluntary liquidation basis—I should say automatic liquidating basis—because every time a contract matures there is just one less, and it will over a period of years, liquidate; it is on a liquidating basis. Therefore, one of the objectives in that plan would be to eliminate the various funds that it now has. In each of those plans I think it called for—at least the purpose behind it would be to eliminate those funds.

Q. You say in each of those plans?

A. Yes.

Mr. T. C. Townsend: Eliminate which funds?

A. What I mean is, eliminate the segregation into special income and special annuity. I mean all the assets and liabilities would be in one general fund.

[fol. 3489] The Court: You mean eliminate the fund principle from the company's operation?

A. That is correct, and have all the operations just as the company, in one general fund.

Mr. Farmer: You say that was a feature or framework of each of the plans?

A. That is one of the basic principles, yes, sir, and that is the reason for transferring it to the general fund.

Q. That just made it convenient—the bookkeeping was separate?

A. Well, not only that, because, as I said before, each fund, whenever contracts are not being issued, it is automatically on a liquidating basis, and the contracts in establishing and setting up the contracts, they were not computed or determined to be on a liquidating basis, but on a perpetuity.

The Court: The result of that, as I understand your entire testimony, is that when a particular form of contract is discontinued, if that contract has been kept in a separate fund and thereby goes on a liquidating basis, it may, in the process of that liquidation, and without any other factors [fol. 3490] coming in, become insolvent?

A. That is true.

Mr. Farmer:

Q. Which had happened.

A. Which had happened. In other words, the history proves itself that that is what happens. You will note that the oldest fund in each instance is less than solvent.

Q. In other words, that was the history as exemplified by this company?

A. Yes.

Q. First income becomes insolvent and then special annuity?

A. That is true.

Q. And then the next one?

A. That has been true in every instance.

* * * * * * *

[fol. 3491] Mr. Farmer:

Q. Did I understand you to say, Mr. Latta, that there were six other plans besides these two?

A. No, I said several other plans that there could have [fols. 3492-3510] been put in there. I think you are referring to the 15 per cent, as to what was the purpose of using the 15 per cent?

Q. That is right.

A. I said there were several plans discussed and formulated. Each one was different, and there were various facts that entered into the reason for using the 15 per cent.

Q. Were the others all graduated plans, graduated like this plan you filed yesterday, except graduated on a different basis, that is, inflicting the loss in different ratios in the different funds?

A. There were different variations.

Q. And the problem is one of where the loss is going to be inflicted, isn't it?

A. That was one of the major problems, yes.

* * * * * * *

[fol. 3511] Q. The Court this morning asked you this question—I think this is a correct statement of the question—would it be possible to—the word wasn't "formulate"—to construct actuarially a plan for reorganization for Fidelity, and your answer was yes.

A. That is correct.

Q. You did not mean to say that it would be probable to construct actuarially, taking into consideration all these other factors that you have delineated since that question was asked as being considerations that an actuary must give effect to in constructing a plan that would be feasible and would probably be successful in operation, did you?

[fol. 3512] Mr. Ray: We object to that, your Honor. That is asking for an opinion.

The Court: You were asking him if it was probable that a plan would be constructed?

Mr. Farmer: Just read the question, if the Court please.

(The question was read.)

The Court: I sustain the objection.

Mr. Farmer: On what grounds is there objection?

Mr. Ray: Giving an opinion.

The Court: You mean the grounds of sustaining the objection?

Mr. Farmer: No, the grounds of the objection. I assume it was sustained on the same grounds as the objection.

Mr. Ray: It asked for the opinion of the witness, which the witness is not qualified to give.

Mr. Farmer: If the Court please, I think the witness is qualified to explain his understanding of the questions and answers.

The Court: Well, you may ask him to explain, but you are asking him now whether he says now that it is probable [fols. 3513-3517] that such a plan could be constructed.

Mr. Farmer: That is exactly the point, your Honor. Your Honor's question asked him if it was possible to construct actuarially a plan for reorganization of Fidelity, and he said yes. Now I think the witness will answer that mathematically speaking it will be possible, but that practically speaking, considering all these other factors, which an actuary must necessarily take into consideration, that it would not be probable that such a plan could be constructed that would be reasonably expected to be feasible.

The Court: Well, that is just another and probably a clever way of trying to get his opinion. I sustain the objection.

Mr. Farmer: It is more than that, if the Court please. I deem that confined to the issue that your Honor must decide.

The Court: Well, I sustain the objection. I don't want to hear any further argument about it. I heard enough of that earlier in the day.

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[fol. 3518] Q. Mr. Latta, since February 12th you have examined only the probabilities of reorganization solely from the viewpoint of a life insurance company? Is that correct?

[fol. 3519] A. It is essentially correct, yes.

Q. So that any testimony you have given today has been mostly from the background of rehabilitation as a life insurance company, not as a face amount certificate company or as any other kind of company into which the debtor might be reorganized? Is that correct?

A. That is correct.

Q. Are you aware of any federal court receiverships in Chapter 10 or 77B proceedings in which there has been a reorganization of a life insurance company?

A. I don't know of any, no.

Q. You would not say that there were not any?

A. No, I am not qualified to answer that question, except that I know of none.

Q. You have just testified about features of Series B. Would there be a greater loss by liquidation to Series B contract holders than by reorganization?

A. Well, if a person had no insurance contract—let me put it this way. In dollars and cents I can't see—it has no bearing, except that there is one feature in the B contract that, if you liquidate, all of those having insurance have lost their protection and could not replace that insurance [fol. 3520] protection in case they were not insurable. That would be an intangible loss that could not be valued in dollars and cents, and would differ with every individual.

Q. And if, in the interim from the time they signed a Series B contract until the time it was cancelled, they became uninsurable, that would be a tremendous loss to them, would it not?

A. If they wanted to keep that insurance, yes.

Q. So that if the debtor is reorganized, in fairness to the Series B contract holders, some kind of insurance would have to be included in the reorganization for those people.

A. Well, to prevent them from getting a loss, there would have to be some provision.

Q. That would be one of the equities to be considered—I mean courtroom equities distinguished from actuary equities?

A. I think that would have some bearing, yes.

Q. You have prepared Exhibits 113, 112 and 111, which are, as far as 111 and 112 are concerned, two of the seven plans that you worked on between February 12th and April [fol. 3521] 12th?

A. I didn't say I prepared these.

The Court: He didn't say seven.

Mr. Huwe: Did you say several or seven?

A. In the first instance, I didn't say I prepared these.

Q. You contributed to them?

A. Yes, I collaborated in their preparation.

Q. How many were there altogether, seven or——

A. I wouldn't state.

Q. Those were presented to the SEC?

A. Yes.

Q. As far as you know?

A. That is correct.

Q. And you were there?

A. That is right.

Q. Let me ask you, what is the standard of evaluating securities in insurance companies for purposes of rehabilitation? What standard is used?

A. For the purpose of rehabilitation I can't say there is any set standard.

Q. Isn't it a fact that the recognized standard is the in-
[fol. 3522] surance conference method of evaluating securities?

A. Well now, that is not set up for the purpose of rehabilitation. As a going concern there is a standard set up by the Conference of Insurance Commissioners. They have set up a standard for evaluating the assets of an insurance company.

Q. Is there an insolvency standard?

A. In determining insolvency that valuation of assets is used.

Q. Would that be the valuation used for the purpose of reorganizing a company?

Mr. Palmer: I object to the question on the ground that the witness has just stated that that was used for a going concern method, which would naturally answer the question of the examiner.

The Court: Sustained.

Mr. Huwe:

Q. Then a going concern method would be the kind upon which a plan of reorganization would be based? Is that correct?

A. No, I stated that there wasn't a definite rule on that. The insurance standard valuation would be used in de-
[fol. 3523] termining the solvency, which would be an assurance of your success for future operations at a later date. That is not necessarily used in a plan of rehabilitation. I have seen a number of methods used.

Q. What standard was used in 111 and 112—West Virginia sound standard?

A. I did not evaluate the assets. I have stated in several instances that I had no part in the preparation of the figures presented in those exhibits.

Q. The SEC refused to consider those plans because you took an assumed valuation rather than an actual valuation of some sort? Isn't that correct, or isn't that one of the reasons for criticism and rejection?

A. The criticism that I mentioned before was that they objected they did not believe that they carried the element—in other words, it wasn't sufficient—that the plan when put into effect, the results attained were not sufficient to be carried out. Their interpretation of the evaluation of the assets I don't know.

Q. One of their objections or one of their suggestions was that an umbrella of court procedure was required in order to prevent cash surrenders? Isn't that cor-
[fols. 3524-3527] rect?

A. In substance I think that is correct.

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[fol. 3528] Mr. Huwe:

Q. In your graduated plans, did you ever determine what amount each fund had in the way of assets?

A. I didn't refer to my graduated plan. He was talking about a specific exhibit. I made no plan.

Q. The plan that you contributed to, marked Exhibit 111.

The Witness: Now, the rest of the question.

(The question was read.)

A. I have never been able to determine the solvency of any of the funds, if that is what is meant by the question.

Q. Did you, in your contribution toward these plans, consider the value of the National Sales Agency's notes?

A. I did not.

Q. You accepted the October 31——

[fols. 3529-3531] A. I didn't contribute to the figures presented in this exhibit. I believe, though, that it shows in that exhibit that the National Sales Agency note is considered at zero, with no value.

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[fol. 3532] Q. You did considerable work with Mr. Ross Thomas, one of the state court receivers?

A. I did some, yes.

Q. What can you say as to his knowledge and ability of [fol. 3533] the workings of Fidelity and the laws and parts of laws connected therewith?

The Court: Mr. Palmer, I don't desire to cut you off or anything, but it seems to me that you are going back now on to a resumption of asking this witness to give testimony —I understood you were through a while ago with the main phase of it.

Mr. Palmer: That is correct, your Honor.

The Court: Is this something that will take another long period of time?

Mr. Palmer: I think one answer will suffice. I want this witness's opinion as to whether or not Mr. Thomas, as a lawyer, being a receiver, was capable of handling Fidelity as a receiver. In other words, this gentleman has worked with other attorneys and other receivers and I wanted to know whether his opinion was that Mr. Thomas was capable of acting as attorney in that receivership and as a receiver.

The Court: Has there been any challenge of that?

Mr. Palmer: There have been more or less indirect challenges whether Mr. Thomas was capable as a state court receiver.

[fols. 3534-3547] The Court: As to his capability I have heard none.

Mr. Palmer: If he is capable then I will withdraw the question.

The Court: All right. We have been talking about his suitability, not his capability.

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[fol. 3548] Arthur B. Koontz called as a witness by the Tennessee contract holders, having been duly sworn, testified as follows:

Direct examination.

By Mr. Farmer:

Q. This is Mr. Arthur Koontz?

A. Yes, sir.

Q. You are a practicing lawyer at the Bar of Charleston, West Virginia?

A. Yes, sir.

Q. And senior member of the firm of Koontz & Koontz?

A. I am.

Q. Do you have several members of that firm in addition to your brother, Mr. Pat Koontz?

A. Several associates, yes, sir.

Q. Mr. Ross Thomas, Mr. Campbell Palmer are associ-
[fol. 3549] ates?

A. They are.

Q. And Mr. Goldsmith, I believe?

A. Yes, sir.

Q. Mr. Koontz, how long have you practiced law in West Virginia—Charleston?

A. Since 1911.

Q. Have you had any experience in financial or banking matters or in connection with banks?

A. Somewhat. I represented a national bank the first ten years of my practice and organized a state bank and represented it as general counsel.

Q. State whether or not you at the present time, are a director of the Pittsburgh Joint Stock Land Bank?

A. No, I happen to be a director of the Home Owners Loan of Pittsburgh, the same in that field as the Federal Reserve is in the commercial banking field.

Q. Are you a director of a Charleston bank?

A. I am vice-president and director of The Charleston National Bank of Charleston, a national banking association.

Q. These banks that you testified about organizing——
[fols. 3550-3553] A. I organized the Union Trust Company in 1913 and consolidated the Union Trust Company and a number of other banks into the Charleston National Bank in the late twenties under the name of Charleston National Bank.

Q. And it is now the Charleston National Bank you are connected with?

A. That is right.

Q. State whether or not you also happen to be Democratic National Committeeman from West Virginia?

A. For the past few months, yes, sir, since about May or June, 1940.

Q. So that your experience in addition to legal matters or legal practice has been considerable in the line of financial matters?

A. That is true.

Q. Mr. Koontz, when did you first become connected in any way with Fidelity Investment company?

A. In the early thirties, I think it was '32, they asked me to do some work for them here.

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[fol. 3554] Q. Mr. Koontz, prior to that time had the directors of Fidelity had under consideration some sort of reorganization or recapitalization of Fidelity—that is, prior to 1938?

A. Not for the past three or four years just immediately prior thereto. They seemed to be doing a very good business in '36 and '37, and I don't remember that they had under consideration—under serious consideration in any way recapitalization.

Q. Prior to 1936 had it been under consideration?

[fol. 3555] A. It certainly had, from that on back to the early thirties the question of depletion of portfolio and reserves and so on. They would talk about trying to get new capital and how we might recapitalize and whatnot, but never did.

Q. What part had you to do, if any, with that effort during that period to secure new capital?

A. None whatever. None in particular. We discussed it at directors' meetings, and I was a committee member part of that time, probably all the time. They had two committees, one an executive committee and one a finance committee. I was on both of them part of the time, probably most of the time, but I never attempted to secure new capital for it before 1938.

Q. In 1938 did you commence efforts toward that end?

A. I did, beginning in December immediately after the SEC suit was filed in Michigan, I attempted to interest new capital and proceeded to try to interest new capital for—oh, about a year after that.

Q. Mr. Koontz, in your past experience had you had occasion, as an attorney, to take part in the reorganization of companies—had you had experience in reorganiza-

[fol. 3556] tion lines?

A. I had.

Q. Will you just state what reorganizations you had taken part in and acted as attorney in?

A. Well, I was receiver for some gas companies in Delaware, and we reorganized those companies. We reorganized here in Kanawha County some other gas companies, now known as the Cumberland group, and The Elk Horn Coal Corporation in a 77B proceeding in 1937. I was active in that in the federal court in Ohio. I was in federal court in Oklahoma City in connection with the reorganization of Consolidated Gas Company.

Q. State, if you will, what efforts you made in 1938 and following that to reorganize or procure new capital for Fidelity?

A. We had a director of Fidelity by the name of Grosscup who was connected with what is known as the Greenfield Banking crowd in Philadelphia, Bankers—not Bankers Trust Company, but Bankers Company, I believe is the name of it. Anyway, it is known as one of the Greenfield institutions; and through that connection we attempted to [fol. 3557] interest the Greenfield crowd—is that Bankers Securities Corporation? I believe that is the name of it. Mr. Grosscup happened to be head of that. That was the first group we tried to interest, and they were very much interested, and made a thorough investigation and talked for some time as though they were going to refinance the company and take care of whatever it needed.

Q. Was it your aim and your object to secure new working capital?

A. That is true.

Q. Operating funds?

A. That is true.

Q. That did not consummate?

A. That is true, it did not.

Q. Then did you make further efforts to secure new moneys?

A. Yes, sir, during the entire year, and probably on into the next year.

Q. What banking institutions or companies or individuals did you approach?

A. Lazard Freres in New York was one. We spent some time with them.

[fol. 3558] Q. Is that a brokerage house in New York?

A. It is, I think, an investment banking house.

Q. A large, well known, well regarded institution?

A. Yes, sir, very high class personnel, well regarded institution.

Q. Any others?

A. G. M. B. Murphy was another one.

Q. What is G. M. B. Murphy?

A. That is an investment banking house, not so large or so strong as the first one mentioned.

Q. What others?

A. I was trying to think of the order of them. Pell and company was another one.

Q. Is that the brokerage in which Mr. Hamilton Pell——

A. Mr. Hamilton Pell is the head of it, yes, sir. Some little Philadelphia life insurance company, the name of which I forget. I spent some time in Philadelphia—a very small company. Then a man by the name of Allebach in Cincinnati had an automobile finance concern, and got very much interested. He came to New York for meetings, came to Wheeling for meetings; somebody went to Cincinnati for other meetings there, and so on, and finally [fol. 3559] made some kind of contract with him.

Q. You mean the company did?

A. Fidelity—some arrangement whereby he was given an option for a certain time to come in on a certain basis. Never consummated.

Q. He was to put in new money?

A. He didn't put in any new money.

Q. He was to put in new money if that was carried through?

A. That is right.

Q. When did you see Pell and company?

A. I forget. I could check up, if that makes any particular difference.

Q. Was that in 1938 or 1939?

A. Late in '39, probably, or early in '40.

Q. Did those negotiations extend over a brief or long period of time?

A. No, they were right extensive negotiations. We had a number of meetings with them.

Q. And was that with a view to their putting new money into Fidelity?

A. It was, yes, sir. And naming some others, I tried [fol. 3560] to get the Lincoln Life Insurance Company people interested, because we had an arrangement with them whereby they carried insurance on a number of our contract holders; had a number of meetings with them.

Q. That is Fort Wayne, Indiana?

A. Fort Wayne, Indiana.

Q. Lincoln National Life Insurance Company?

A. That is right, Lincoln National Life Insurance Company.

The Court: Mr. Koontz, with reference to your negotiations with Pell and company, what was the rock on which they foundered?

A. Well, we have to earn so much money on reserves, they didn't think it was set up on a basis so we could earn that reserve requirement. It was 4 or 4½ per cent and 5 per cent, some of them, I think. They just didn't think we could earn that money under the conditions; and they wondered, since changing conditions, whether or not a company operating in this field might be successful in the future. It was just on general grounds.

Q. Did the fact that the assets of the company may [fol. 3561] not have been sufficient to cover all its liabilities have anything to do with the failure of those negotiations?

A. Your Honor, that is why we were negotiating, was to get money to supplement our common fund so that the company, no matter how these obligations were—could at all possibly meet its obligations.

Q. It is now stated that the company is about 10 per cent insolvent on the basis of market values. I want to know whether that particular feature of it had anything to do with Pell and company not coming into it.

A. I don't know that that was discussed at all. Of course, we were going to have to have a very substantial amount of money; we talked about from one to two million dollars with Pell and company, and they talked about some smaller picture or Fidel, and talked about being interested in a half million dollars. I don't know whether it was the insolvency of some of these funds or the amount of money involved or the lack of soundness economically of the system or just what it was that caused them to turn it down. I would say a combination of them, probably.

The Court: All right: go ahead.

Mr. Farmer:

Q. You say you were talking about Fidel at that time? [fol. 3562] A. They talked some about Fidel, yes.

Q. Did they, or not, indicate a willingness to take over Fidel at that time?

A. Oh, they did; they indicated a willingness to do some financing in connection with Fidel to make it a larger company.

Mr. T. C. Townsend: During what time was that?

A. That was at the same time we were negotiating for funds for Fidelity; I don't recall the date.

Q. Do you recall the year?

A. Either late in '39 or early in '40. If that date is essential I can get the exact date that I was in New York with Haskins and Sells' man, Mr. Clarke, because we were there for several days.

Mr. Farmer:

Q. Did the directors of Fidelity look with favor on letting Fidel go — them at that time?

A. No, they did not.

Q. Did you have any other negotiations with another investment house?

A. Yes, that brings out another one, the Atlas Corporation, Floyd Odlum's concern. Odlum had been a director [fol. 3563] in this company formerly, and I worked with them for some weeks, and that wound up just like most of the others. Odlum was interested, he said, in taking over Fidel—take it over and liquidate it. He told me that he would take it over and just liquidate it rather than carry on the business.

Q. Where was Mr. Odlum?

A. Well, we speak of him being in New York. His office is actually across in New Jersey, either Newark or Jersey City.

Q. That was a corporation, one of the big companies?

A. Yes, that is true, one of the very large ones.

Q. And Mr. Odlum is quite a prominent man in financial circles—investment circles?

A. Yes, sir, legal circles and financial circles and so on.

Q. Investment companies?

A. Yes, sir.

Q. Holding companies and so forth?

(No answer.)

Q. Did you see anyone else in connection with the matter?

[fol. 3564] A. Mr. McCandless, the head of the Lincoln National Life, put me in touch with an old school friend and former business associate of his in Chicago whose name I forget. He managed for a number of years the Hearst papers and had had some insurance experience. I saw him for two or three days and he finally turned me over to what is known as the Chicago Corporation.

Q. What was the Chicago Corporation? Is that as big as it sounds?

A. The Chicago Corporation was organized about—oh, during the panic, as they say themselves, to take advantage of bargains. I forget the head of that. The head of it was formerly secretary to Mr. Cummings, who is head of the largest bank in Chicago, a man with some experience, and they were interested in looking into this for the reason that they had been asked not very many months before to refinance Investors Syndicate; they were very familiar wtih the general type of business; and they did look into this, asked me to submit all my reports, which I did, and finally decided that they did not want to go into it.

Q. State whether or not you negotiated with a Morris [fol. 3565] Plan bank?

A. I did, yes, for some time.

Q. Where were they located?

A. Well, over the country generally, but I negotiated with Mr. Arthur Morris, who is president of the New York bank, and is, I think, chairman of the board of the top company; the Morris Plan Corporation of America I believe is the name of it. I met with him and with his directors.

Q. Did he go into Fidelity?

A. Very thoroughly.

Q. Its operations?

A. Very thoroughly. He is another one that had some experience in his early business career of selling investment contracts, and he knew generally about the business, and he and his directors went into it very thoroughly.

Q. Did you see also the Cleveland brokerage firm of Otis and Company?

A. That is right. I did.

Q. Can you think of any others that you contacted which you have not already mentioned?

[fol. 3566] A. No, sir, I don't outside ones. I will say this, I had a meeting with the main business men of Wheel-

ing and talked it over with them. They appointed a committee, and a number of them talked this over with other members of the company. I didn't negotiate very much with them except I laid the plan before them.

Q. And what was that plan?

A. Well, the plan—no interest evidenced.

Q. No what?

A. I mean the result was no particular interest was evidenced by them in going into it.

Q. These negotiations with these financiers and investment men and brokers and insurance men throughout the company, you said, commenced in 1939 and extended over into 1940?

A. I said late in '38.

Q. Did there come a time when Mr. Allen G. Messick came on the scene and manifested an interest?

A. That is true; Allen G. Messick and a man by the name of Bernard Rosset—we spoke of them as Rosset and Messick, the way they were written in the various papers—from Chicago.

[fol. 3567] Q. How did it happen, if you know, that they began looking into the company?

A. Hal Pulfer, who was in charge of the sales office in Chicago, seemed to be the one that got them in it.

Q. You didn't contact them yourself?

A. No, not at all. I think he and Messick were probably schoolmates. Knew each other at school, possibly.

Q. Did you have any part in the negotiations with Mr. Messick and Mr. Rosset that led to the drafting of this contract that has been filed here and introduced in evidence, referred to as the Messick contract?

A. Yes; I don't know what the contract is that has been introduced in evidence, but I did have considerable part in the negotiation with Rosset and Messick which led to their coming to Wheeling and entering into a contract which called for putting up a substantial amount of money upon certain conditions, a half million dollars as I remember is what they were committed on, if certain things were true and so on.

Q. Their plan was, was it not, that they were going to capitalize a new company separate and distinct from Fidelity?

[fol. 3568] A. That is true.

Q. With a half million dollar capital?

A. That is true.

Q. And issue new certificates and assume such liabilities of Fidelity on old outstanding certificates as the new company, at its option, might elect to assume.

A. That is true.

Q. And sell through the existing sales force of Fidelity?

A. That is generally what the plan was.

Q. The idea was that the new money that they put in would not be subjected to the risk that it would be if it were put in the old company?

A. That is right.

Q. Do you know the reason why that contract was not carried out—why that plan fell down?

A. I don't know the exact reason. I know there seemed to be some misunderstanding and scrapping between Rosset and Messick themselves. I don't know whether any notice was served on the company which gave any particular reason for their not going ahead with it or not.

Q. Did you know that Mr. Rosset brought a suit in Chi- [fol. 3569] cago against Mr. Messick charging breach of contract and seeking damages for his failure to carry that out?

A. I didn't see the praecipe or the declaration. I heard that that was true and saw some correspondence on it.

Q. I believe Fidelity was also made a defendant in that bill?

A. That is true.

Q. Did Mr. Messick later become connected with the company after that?

A. I don't know whether it was later. He did become connected with the company as chairman of the board, I think was his title. I am not sure but what that was before the filing of the suit. In fact, I think it was.

Q. Who was Mr. Rosset? Do you know what business he was in?

A. Mr. Rosset is a banker. He is head of what is known as the Metropolitan Trust Company. It is not a regular commercial bank; it is a trust company.

Q. Of Chicago, Illinois?

A. That is right.

Q. Do you know what Mr. Rosset charged in his bill seek-

[fol. 3570] ing damages from Mr. Messick for failing to carry out his contract—what his contention was about it?

A. You mean in the million dollar suit?

Q. Yes.

A. No, sir, I do not. I have never seen the declaration, if there was one filed.

Q. What was the reason for Mr. Messick becoming connected with Fidelity as long as the contract was not carried out, do you know?

A. No, I don't; I wasn't around Wheeling very much at that time, and I wasn't present when he was elected chairman of the board. I don't know how that came about.

Q. Do you know what services Mr. Messick was rendering to the company at that time that caused him to commence drawing a salary?

A. No, I do not. He was getting familiar with the affairs of the company when he was negotiating for Rosset and himself, and the next thing I knew he had been chosen chairman of the board of Fidelity.

Q. That was in 1940?

A. 1940. I am not sure of the month.

Q. And your negotiations with all these other men and [fol. 3571] houses—investment houses, bankers and so forth that you have outlined occurred prior to the time that Mr. Messick became chairman of the board or not?

A. Yes, that is right.

Q. After he became chairman were the efforts continued to secure new money, that is, after the deal with him and Mr. Rosset fell through?

A. I understood from him when I would see him occasionally that he was attempting to secure new money or a reorganization of some kind. I have not been active——

Q. I believe your firm, or Mr. Ross Thomas, did considerable work for the company with a view toward compliance with the Investment Companies Act of 1940 prior to the time that that act went into effect, which was January 1, 1941. Is that true? Were you familiar with that?

A. Well, in conection with the registration statement that work was done in 1939.

Q. In 1939 he did that?

A. Yes.

Q. Did you, or any member of your firm, have anything to do with advising the company on matters of that kind [fol. 3572] with reference to the applicability of its attempt

to operate under the Investment Act of 1940? I do not mean applicability; I mean whether or not the company would attempt to operate under the Investment Act?

A. That is right. The registration statement was prepared in 1939, sir. The Investment Act became effective later than that, as I remember.

Q. Became effective?

A. With the advice of the company I registered with SEC before the effective date of this instrument we are talking about.

Q. Did you or any member of your firm assist the company in the legal matters of amending its charter so as to get the authority from the State of West Virginia to engage in the life insurance business instead of the investment certificate business?

A. We did.

Mr. T. C .Townsend: I object to that question and the answer. That is not what the charter did, and that wasn't the purpose of the application. That is, that is not what the amendment to the charter did, and that wasn't the purpose of the application, to substitute life insurance for an [fol. 3573] annuity company. It is all in the evidence here. All that charter did was to take on, in addition to what they already had, the feature of life insurance.

The Court: Overruled.

Mr. Farmer:

Q. Mr. Koontz——

The Witness: May I elaborate on that answer?

Mr. Farmer: Yes, sir.

A. I am not sure as to who drew that charter. As I remember, the amendment of the charter was drawn in the head office and was sent to us to file with the Secretary of State. As I remember, that was the way it was handled; we didn't actually do the work, make a study of the amendment, and so on.

Mr. Farmer: I ask this question because I don't recollect clearly. I did think that that amendment had been put in, and of course it will speak for itself—was already in evidence.

Mr. Palmer: Yes, it is in evidence in the minute book, is it not, Mr. Jaegerman?

Mr. Jaegerman: It is also in evidence in the charter, I believe, one of the documents——

[fol. 3574] Mr. Farmer: I thought that was one of the first documents filed.

The Court: If it is not in evidence it ought to go in.

Mr. T. C. Townsend: There was a copy of the charter put into evidence, your Honor.

Mr. Farmer: Well, it will speak for itself and decide whether my recollection is right or whether Mr. Townsend is right.

Q. Now, in 1941, after the Investment Companies Act went into effect and after the company had ceased to sell any new investment certificates, did you take any part in the consideration of plans for carrying on the operations of the company as an insurance company, and if so, state just what you did?

A. Well, its charter had been amended and they had hoped to start writing life insurance, but they were never able to get the green light from the Commissioner in Charleston. Various statements were worked on, various information asked for by the Commissioner from the company, some of the auditors came to our office with blanks and asked us to help them fill out those blanks, various [fol. 3575] work of that sort with a view of preparing the company to go into the business of life insurance if the statement, in the Auditor's judgment, showed that it should be permitted to write life insurance. We were in general touch through that last period.

Q. Did you attend any conferences at which representatives of the Securities and Exchange Commission were present where there was discussed possible plans for reorganizing the company?

A. Yes, I visited individually with some individual members in and around the Securities and Exchange. I went and had a conference with Mr. Risley at Mr. Schencker's office, at which Mr. Schencker was present and two or three of his assistants whose names I forget, except a Mr. Carver; and then we had a general town meeting, I think it was on March 17—I believe that was March 17th, as I remember.

Q. You say a general town meeting. What town is that?

A. I mean quite a conference in the general counsel's office. We had people from various sections of the SEC, [fol. 3576] had the Chicago representatives of Fidelity and

Wheeling representatives, and I believe Mr. Goldsmith was with me. Many people there. I don't know how many.

Q. Was Mr. Latta present at that meeting?

A. Mr. Latta was present, yes, sir.

Q. I believe it has been testified by Mr. Latta, if I am not in error, that that meeting in Washington was on April 1st. You said that you attended the meeting on March 17th. Did you attend two meetings or one meeting there?

A. Wait a minute. I am pretty sure there was a meeting on March 17th, rather large meeting. These gentlemen should be able to straighten us on those dates. I did meet back in Washington again early in April.

Q. Then you attended two meetings? Is that right?

A. I attended more than two meetings, but I—I attended that one large meeting, which I thought was—I thought was March 17th. I have some correspondence about it from Mr. Schencker and a copy of a letter from Mr. Jaegerman, Mr. Jaegerman asking Mr. Risley for certain information.

Q. Will you refer to that——

[fol. 3577] A. If I can find it. I just remember those letters. (Witness looks through papers.) The one in Mr. Lane's office, Mr. Sims was there, by the way, and I think Mr. Justice. A letter from Mr. Schencker dated March 12 asked us to be there on Monday afternoon, March 17th, at 2:30, and I replied that I would be there. I don't remember that that date was changed. Copy of a letter from Mr. Jaegerman to Mr. Risley, which was sent to me—that is dated March 13th and he asks Mr. Risley to bring certain information.

Q. Asked him to bring certain information for the meeting of March 17th?

A. For the meeting of March 17th.

Q. Is that the town meeting that you were talking about?

A. That was the large meeting.

Q. And Mr. Sims was there?

A. Yes, sir.

Q. And Mr. Harlan Justice was there?

A. Yes, sir, Mr. Sims I know was there, and as I remember Mr. Justice was there.

Q. You said you were also present at a meeting at which [fol. 3578] Mr. Latta——

A. Mr. Latta was at that meeting, as I remember, too. Mr. Latta was at that meeting.

Q. Could you establish from your files whether or not you attended a meeting before the SEC on April 1st in Washington?

A. I was in Washington April 1st on Fidelity's business. I don't remember whether that was the day I was over at the SEC or not. I as an individual went and conferred with some of the people from SEC from time to time by myself.

Q. Do you recall whether or not Mr. Goldsmith went with you on April 1st?

A. No, sir, I don't about that date. Mr. Goldsmith was with me a trip or two. Mr. Goldsmith was with me one trip when Mr. Latta was present.

Q. Do you recall that Mr. Latta, Mr. McNulty and Mr. Risley were present at that meeting?

A. They were. I mean they were at a meeting. I don't know whether that was the meeting of April 1st.

Q. State whether or not at one of those meetings at which Mr. Latta was present he had some plans that he [fol. 3579] had prepared, rather elaborate plans—he didn't prepare them, but that had been prepared up there that he had collaborated with the officers of the company in plans for reducing the contract liability or cash liability to your contract holders by——

A. That is right, he did.

Q. By taking off 15 per cent, or something like that, from them.

A. Taking off a certain percentage all the way across the board, or taking off different percentages of different contracts and so on.

Q. And you were there at that conference when those ideas that he had, or plans, were laid before the members of the SEC and discussed?

A. That is right, I was.

Q. Was Mr. Jaegerman present at that meeting?

A. Mr. Jaegerman was present at the only meeting at the general counsel's office, I know, I remember that we were. I don't know about these various conferences, I don't know who was at all the conferences, except I remember that large conference that Mr. Jaegerman was there.

Mr. T. C. Townsend:

[fol. 3580] Q. That was the March 17 conference?

A. I think so. That is what my correspondence shows, and I don't see anything that would indicate that that was changed from that date.

Mr. Farmer:

Q. What was the attitude expressed by the representatives of the SEC at that meeting at which you discussed those plans Mr. Latta had with him there—that is, the attitude of the SEC toward those plans?

A. Different attitudes by different members, just as there were different attitudes with different members on our own side. It was a question whether or not you should take a uniform percentage or whether or not some of the funds were solvent and they should let them alone or cut them down a very small percentage and take the large percentage off the others; and we broke up without having any particular conclusion on any plan.

Q. State whether or not the chief concern of the company, or the main pressing problem, was these maturing contracts of the old first issued contracts, special income and special annuity?

A. That is true.

Q. The drain on the company's cash position?

[fol. 3581] A. That was the main concern, of course, of the company, and also of the Commissioner and also of the SEC.

Q. Was it contemplated at that meeting, was it discussed, about court proceedings at that time, that the company would go into court?

A. Yes, we referred a number of times during the discussion to a proceeding of some kind that would be necessary to protect the company. That was discussed.

Q. Was there a discussion about what court the proceedings would go into?

A. No, a general discussion as between state court and federal courts. I don't know that any particular federal court was mentioned, if you mean it that way, a discussion as between state and federal courts.

Q. That is right.

A. That is right.

Q. What was the attitude of the SEC? Was it in a position of impartiality or did they have some partiality about it?

A. No, I didn't see any partiality about it. They always took the position that "that is a matter for you to decide; you are to choose your jurisdiction." I had discussed it [fol. 3582] not only that day but a number of times with a number of them and their decision always was, "We cannot decide for you what your jurisdiction should be."

Q. State whether or not at the time you had that conference it was recognized by the directors of Fidelity that some definite action must be taken without delay looking toward the rehabilitation of the company?

A. It was recognized by the members of the company and it was recognized and so stated by Mr. Sims, who was present, and seemed to be recognized by the members the SEC who were there.

Q. Did you get a letter from Mr. Sims dated March 25, 1941, notifying you in effect that something must be done, otherwise he would be forced to cause proceedings to be instituted by the Attorney General's office?

A. Yes, sir, I got a letter the latter part of March; I don't remember just what the date was. I believe I have the original of it here, sir.

Q. A copy of that has already been filed as Exhibit 94. Have you got the original letter?

A. Dated March 25, yes, sir.

Mr. Palmer: There was a copy of the copy filed, which [fol. 3583] was questioned, and I promised that would be connected up later, your Honor, and I would like to have the original go in the record, if possible, to make good my promise.

The Court: If Mr. Koontz wants to part with the original it may be put in evidence in substitution for the copy.

Mr. Farmer: Without reading it carefully, it appears to me to be the same. Do you agree, Mr. Ray, that the copy is a correct copy of the original or copy that has been filed?

Mr. Ray: It seems to be.

Mr. Farmer: Then it is stipulated that the copy is a correct copy of the original, and Mr. Koontz need not file the original?

Q. Mr. Koontz, those plans that Mr. Latta—that he introduced yesterday or day before, when Mr. Latta was on the stand—those plans that were referred to about taking 15 per cent level off all of them or distributing the loss among the various contract series—appear not to take into consideration the fact that the company's assets had been deposited—practically all their assets [fol. 3584] had been deposited with state officials in various states to secure the liabilities in those states. What consideration was given to that situation in your discussion?

The Court: If any.

Mr. Farmer: If any.

A. I am not sure what that discussion was, offhand. I don't remember that there was any discussion on that line. I don't remember that there was any consideration given to that, except this one thing: in West Virginia it was—everybody knew that there was a surplus in West Virginia, but that deposit was made to secure contract holders outside where no deposits were made or where insufficient deposits were made. That was always recognized in all these discussions.

Q. There have been filed here, Mr. Koontz, some descriptive booklets that the company issued and used in conection with the sale of its Series B income reserve contracts, filed as Exhibits 85, 86 and 87, setting out certain financial statements and other statements with reference to state deposits, the company's business and so forth. Had you had anything to do with those descriptive [fol. 3585] booklets?

A. Prepared when, sir?

Q. Well, I will hand them to you. In 1939 and 1940, I think, after the Detroit proceedings.

A. We were consulted from time to time about notes to be put on the Auditor's reports, explanations to make, so that we would not be in—violate the injunction of the Detroit court, and to that extent we did have something to do with the preparation of the statements made after that Detroit proceeding.

Q. When you all were working on these plans, having conferences with the SEC, were you cognizant of the fact that the securities in these reserve funds—various securities in the reserve funds—had been deposited with state

authorities and were subject to the requirements of the state with respect to all the contract funds of Fidelity Investment Association, and if those funds were not held for the sole benefit of the holders of the particular contracts as stated in this descriptive booklet filed as Exhibit 85 on page 11, note 4?

The Court: Mr. Farmer, it seems to me that you are assuming something there that is a question for legal de- [fol. 3586] termination. Although there has been no objection to this question, I don't feel that there ought to be any such assumptions made. You may ask him if he was cognizant of the fact that that statement is in the booklet, but if you are assuming that statement to be true as a matter of law, it may be subject to some question.

Mr. Farmer: I will reframe the question in accordance with your Honor's suggestion, although I am still of opinion that that is a fact.

The Court: I understand that is your contention, but there may be other contentions of other attorneys. Go ahead.

Mr. Farmer: Of course, nobody has made any yet, in the proceedings that I have heard.

The Witness: Are you going to reask the question?

Mr. Farmer: I will try to state it again. Were you aware of the fact when you had those conferences discussing those plans that that statement that I referred to was in that descriptive booklet?

A. Yes, I knew about this statement in the descriptive booklet, of course. I don't know that it occurred to me [fol. 3587] at the time we discussed the latter plans, but I knew of this.

Q. When those booklets were prepared by the company and sent out for use in 1939, after the Detroit proceeding, did you have any conferences with any representatives of the SEC regarding those booklets and regarding the accuracy and sufficiency of those descriptive statements in the booklet?

Mr. Jaegerman: Your Honor, when those booklets were first offered there was a discussion about that. May I ask Mr. Farmer the relevancy?

The Court: I think I will overrule any objection to it, anyhow, so go ahead.

A: When the first statements were prepared there were some representatives of the SEC in Wheeling, Mr. Jackson and someone else whose name I don't recall, and of course they always took the position they couldn't advise us on how to prepare a booklet, but they were very kind in saying, "We see no objection to that. Of course, that is our idea. There is no objection to that so far as we know;" and the first statement was put in after advising with them. Later [fol. 3588] on, when Haskins & Sells came in and made the audit, it seems they had had a great deal of experience preparing the booklets, and they talked over with us the various notes which were attached to these statements, and they kept in touch, and did keep in touch with the SEC, and Mr. Clarke and I made a special trip to Washington once and went into the SEC relative to this.

Q. Mr. Clarke, you say?

A, Mr. Clarke, who is manager of Haskins & Sells. He is the one that finally gave the clearance on this booklet, Clarke of Haskins & Sells.

Q. Who did you confer with at the SEC about it?

A. I usually conferred with Mr. Kline or Mr. Lane, but I don't think they purported to pass on this. Mr. Clarke knew the contentions of the auditors, and I was in to see Mr. Andrew Jackson, head of the—I am not saying I conferred with him about this; some auditor from Tucson, Arizona—I don't remember his name—but Mr. Clarke being the one who was familiar with the auditors, was the one that did the talking on this, and we had given him our judgment on whether or not this statement violated any part of the injunction order in Michigan, and we were merely talking [fol. 3589] further with the SEC.

Q. Mr. Lane was general counsel?

A. Yes, but Mr. Kline was the man generally in charge of this. Sometimes he referred us to somebody else.

Q. Will you state, Mr. Koontz, how anyone there at that meeting expected to consummate a plan like one of those presented by Mr. Latta that he had there with him, the situation being as it was with reference to those deposits in the states?

A. How anyone at our meeting in Washington expected that?

Q. Yes, sir.

A. Well, that plan was a new plan and not very many people were very familiar with it.

Q. Had you seen it before you were there?

A. I am not sure that I did. Doubt if I had seen his completed plan. I had heard some talk about it over the phone, or probably had some second hand reports. I don't believe I ever saw the plan called the completed plan till I went to the Washington meeting.

Q. Well then, will you state, in your own words, the re-
[fol. 3590] sult of the last, final conference that you had with the SEC before the proceedings in the state court occurred?

A. What was my last conference? I remember very well the general result of our big meeting. I talked to some men around the SEC after that, some individual men. I am not sure whether I had a conference after March 17th. Maybe I had one—I was there on April 1st. I can't get my dates straight on that. I can give you the general result after the March 17 conference: "No definite conclusion."

Q. I want to ask you this, Mr. Koontz, because Mr. Latta has stated on the stand that he attended one conference on April 1st, and you have stated that you thought he was at the March Conference or the town meeting that you referred to on March 17th. There seems to be that conflict between the recollection of you gentlemen to that extent. Can you make sure that that meeting was held on March 17th, or is there any likelihood that it was postponed or it was not held until April 1st? Can you be positive about that?

A. No, but I feel sure that I have in my files somewhere a list of the names of the people who attended that confer-
[fol. 3591] ence. I think I jotted it down.

Q. The March 17th conference?

A. Well, whenever it was. It was called for March 17th.

Q. Would you mind doing that?

A. I will have to do that back at my office. I don't think I have it with me. I am not sure that I have, but usually after those conferences I marked down——

Q. I would like to clear that up, if I can, in some way.

A. Excuse me just a moment.

Mr. Farmer: Mr. Jaegerman, maybe you can clear it up and give us your recollection. Did you attend two such meetings?

Mr. Jaegerman: I attended more than two.

Mr. Farmer: More than two at which Mr. Latta and Mr. Koontz were present—I mean two at which they were present?

Mr. Jaegerman: I don't remember how often Mr. Latta was present.

Mr. Farmer: Have you got anything that would enlighten us about the March 17th meeting or the April 1st meeting? [fol. 3592] Mr. Jaegerman: What is the difficulty about the dates? What are you trying to prove?

Mr. Farmer: I stated to Mr. Koontz the reason I wanted to clear it up, because there is some discrepancy between Mr. Latta and Mr. Koontz, and evidently one of the other is mistaken.

The Court: Do you regard the question of date as being of any importance?

Mr. Farmer: No; I don't regard it as being so terribly important, except that Mr. Latta testified that those plans were prepared by him the night before the meeting of April 1st, and Mr. Koontz had not seen them, and he only attended one meeting, and apparently Mr. Koontz's recollection was the other way, that there were two meetings at which Mr. Latta was present.

The Court: You can't change that testimony so unless there is some importance about the date of the meeting, let's go ahead.

Mr. Farmer: In fairness to Mr. Koontz, I thought I should—and I told Mr. Jaegerman to give us his recollection about it, if he had any notes or information about the [fol. 3593] meeting.

Mr. Townsend: He didn't say he didn't have any information about it.

Mr. Farmer: Would you mind, Mr. Jaegerman, stating your recollection of the facts?

The Court: I think you had better just go ahead, Mr. Farmer. We don't need to get a lot of stuff on the record about some discrepancy——

The Witness: I was invited to Washington on the 17th; I was in Washington on the 17th on Fidelity business, so I just assume it connects. There is a Securities and Exchange Commission letter here. I know—I feel sure we had that meeting on *April* 17th. I was in Washington again on April 1st. I don't remember what meeting that was, though, whether an individual meeting, whether it was with Latta and probably two or three others or what. The big

meeting, I feel sure, though was the 17th, because I see nothing that would indicate any change of that date.

Mr. Farmer:

Q. I will ask you this. After the final meeting, the April 1st meeting, was any definite decision reached about whether [fol. 3594] the company voluntarily, of its own initiative, be able to work out any sort of plan that would enable it to carry on business?

A. A decision was arrived at to the effect that it could not carry on or did not see how it could carry on. It was not doing business—it was not permitted to do business, and Mr. Sims had stated to them that he wasn't going to permit them to do business unless there was a change in the situation.

Q. Then were you notified later that Mr. Sims had called on the Attorney General to institute proceedings in the Kanawha County Circuit Court?

A. I was, yes. Mr. Sims wrote me that letter, and I checked with the Assistant Attorney General relative to these jurisdictions relative to this matter in general, and we started doing some work on it. I notified Mr. Foulk at Wheeling about it; I notified Mr. Marshall at Washington.

Q. Was a directors' meeting called about that time?

A. I understand so. I wasn't a director, and so, of course, I didn't get their notice. I won't say I wasn't told that there would be one. I understood there was one.

[fol. 3595] Q. Were you furnished with a copy of the resolution authorizing Koontz & Koontz to represent the company?

A. That is right, we were. I have forgotten what that date was, though.

Q. Have you got that with you here?

A. Yes. We were notified that we were appointed counsel to represent Fidelity in the proceeding which we are talking about—notified by letter.

Q. Who notified you?

A. Mr. J. F. McNulty, vice-president and secretary, wrote April 10th as follows:

"Koontz & Koontz, Union Building, Charleston, W. Va.

GENTLEMEN:

This is to avise you that the board of directors of Fidelity Assurance Association, at a meeting held on April 7, 1941,

at which a quorum was present, authorized the employment of your firm as counsel to represent this association in the pending suit instituted by the Auditor and ex-officio Insurance Commissioner of the State of West Virginia. The formal resolution as adopted by the board is as follows:

[fols. 3596-3597] " 'Upon motion of Mr. John Marshall, Sr., seconded by Mr. F. H. Pulfer, the law firm of Koontz & Koontz is authorized to represent the association in the pending suit instituted by the Auditor and Ex-officio Insurance Commissioner of the State of West Virginia'."

Q. Did you appear and represent the company—make your appearance?

A. Someone from my office did. I accepted service for the company and appeared for the company.

. . . . . .

[fol. 3598] Mr. Farmer:

Q. You said that Mr. Sims was at this conference in Washington, whether it was March 17th or April 1st. Were you familiar with any sort of ideas or plans that Mr. Sims had for rehabilitation of the company or converting it into a life insurance company, what his ideas were, whether they corresponded with those of the company or not?

[fol. 3599] A. I don't remember that he had any particular ideas about rehabilitating the company. He was leaving that as the task for the company, that he was not going to let them start writing life insurance until the company got in such shape financially that they could make a statement that would justify his permitting them to start business.

Q. Well, at these conferences that you had before the SEC, were the only plans—I don't want to ask a leading question—state whether or not the only plans under consideration were plans with a view of the company continuing in business as an insurance company and not a face amount certificate company.

A. The company had just changed its charter and expected to continue in business as an insurance company handling this business of face amount certificates, if it handled it, as a side line rather than as the main object of the corporation, like some insurance companies that were mainly insurance companies but did write contracts.

Q. Did you know anything about the directors of the company appointed a so-called reorganization committee?

[fol. 3600] A. I heard of that only. I wasn't present at the meeting where that was done. I heard there was one and Mr. Messick was a member of it. He told me that he was chairman of that, I believe.

Q. Mr. Allen Messick?

A. Yes.

Q. Did you talk with him about it?

A. I did. He told me——

Q. When did you talk with Mr. Messick about that?

(No answer.)

Q. That is, after the state court proceedings or before?

A. It was shortly after he was appointed. I saw Mr. Messick in Washington April 5th, I believe is the last lengthy conference I had with him. I talked with him a number of times by telephone, however.

Q. Were you acquainted with Mr. James R. Fleming?

A. I am, yes, sir.

Q. When did you first become acquainted with Mr. Fleming?

A. Sometime early this year. That is 1941.

Q. Prior to the state court proceeding?

[fol. 3601] A. That is true.

Q. How did you become acquainted with Mr. Fleming?

A. In the station at Washington, Mr. Messick introduced me to Mr. Fleming. I was getting off of an early morning train waiting for a taxicab, and Mr. Fleming happened to be getting off the train, as I remember, from somewhere else, and Mr. Messick introduced me to him.

Q. Did you have any conversations with Mr. John Marshall after the state court proceedings with reference to this proceedings?

A. A number, yes, sir.

Q. Where did you have those conversations and state what they were.

A. Well, I had a great many conversations with him, and most of them were in Washington, unless I was conversing with him by phone. I was in Washington a great deal during the early part of this year. I saw him every day for several days.

Q. Did Mr. Marshall express any dissatisfaction with the course of the proceedings, the fact that they were in the state court rather than in the federal court?

A. No, none whatever. He did raise this question: he [fol. 3602] said that there were some people that thought this proceeding should be in the federal court.

Q. Did he say who they were?

A. No. Finally it developed that Fleming was one that felt that it should be in the federal court.

Q. You say it finally developed?

A. That is right; that is right. I had a meeting with Mr. Marshall and Mr. Fleming in Washington.

Q. Do you know who Mr. Fleming was representing at that meeting?

A. Yes; if you will permit me to clear that I will go back and say that Mr. Fleming came to my office prior to our Washington meetings.

Mr. T. C. Townsend:

Q. Here in Charleston?

A. Here in Charleston, yes, sir.

Mr. Farmer:

Q. How did it happen that Mr. Fleming came—at whose request?

A. He had been put in touch with this situation by Mr. Messick, who is a very good friend—and again a college friend, I think classmates; they seemed to be very close friends—Messick and Fleming—about May 1st Mr. Fleming came to my office.

[fol. 3603] Q. Here in Charleston?

A. He had phoned me some days before from Fort Wayne and asked whether I would be home and so on and said he wanted to see me and talk to me about this matter; that Mr. Messick had been talking to him and had gotten him interested; and he did come, as I remember, on May 1st.

Q. He came down here to Charleston?

A. Yes, sir.

Q. To a conference at your office with you?

A. Yes, sir.

Q. Was anybody else present at the conference?

A. No, just the two of us.

Q. What was the discussion about?

A. The general situation and what it would take to rehabilitate the company, to put it in shape to do business. He talked to me about his conference with Messick—and

by the way, before that Messick had advised me by phone several times before that he had succeeded in getting Fleming interested in getting him actively to go into the company or the reorganization plan and could get a substantial amount of capital, if need be could get a million dollars. [fol. 3604] That was Messick: and then Fleming came over for a conference.

Q. Was that after the Rosset and Messick deal fell down?

A. Oh, yes.

Q. He still had capital, did he?

A. Yes, from another source entirely. That was this year. We are talking now about this year. So Mr. Fleming did come to the office for a conference, and he said, if you care to have me——

Q. I would like for you to go on and give us——

The Witness: Any objection to the result of that conference, your Honor?

The Court: No.

A. Well, he wanted to know why we had proceeded in the state court rather than the federal court in a matter like this, and we discussed that and just went over the ground, that the ones who thought we were familiar with this before the proceeding was filed had covered, and we referred him to the state statutes, and we discussed the advantages and disadvantages of state courts as against the proceeding under Chapter 10 of the Chandler Act; and he talked about [fol. 3605] the people he represented.

Q. The people he represented?

A. That is right, the group he represented in Fort Wayne, and wondered if we could work together on this and wondered if I was wedded to Messick or Pulfer and asked what I thought about them and about their ability and so—a general discussion along constructive lines.

The Court:

Q. During that discussion, Mr. Koontz, was it the thought of both you and Mr. Fleming that the proper thing to do was to reorganize Fidelity in some way, whether in state court or a federal court?

A. That is true, yes, sir, reorganize it by rehabilitating it with some capital. That is right. But it had already been changed into an insurance company. He talked more insur-

ance than he did these investment contracts, and he asked me specifically whether or not I thought the assets ought to be sold to a life insurance company, disposed of, closed up, or whether or not it could be reorganized, and talked about how to reorganize it, if we did, what people to take care of.

Mr. Farmer:

Q. What do you mean "what people to take care of"?

[fol. 3606] A. I meant the contract holders, the preferred stockholders, the common stockholders.

Q. Well, I hope you gentlemen at that conference didn't forget the contract holders.

A. The contract holders were first. And we agreed that if there was any way of giving present contract holders, although it looked as if there was no equity for them whatever, the right to buy in later on by way of rehabilitation, it should be done.

Q. You don't mean that there was no equity for the contract holders?

A. I mean the stockholders; I beg your pardon. Then he left that conference asking me if I couldn't draw a plan of reorganization and get it to him by the following Monday. That was about Thursday. I remember I said to him, "I don't think I am that good; I don't know enough about reorganizations for that. It is too soon." He said, "Get me something if you can, because I want to talk it over with my associates and I want to tell them that there is some chance, we think, of rehabilitating the company."

Q. Did he say who his associates were?

[fol. 3607] A. Yes, I questioned him about his associates. Frankly, I thought he might represent the Lincoln Life Insurance Company, with whom we had been dealing. He said definitely he did not, but he did represent the same interests in Fort Wayne, being the Lincoln National Bank people, and had them as associates—the same people that did control the Lincoln National Life Insurance Company.

Q. They are in South Bend, Indiana, and Mr. Fleming was from South Bend?

A. No, Fort Wayne. I didn't get a plan to send to him like he had asked, of course. I was at Cincinnati the first of the next week, and I tried to get him on the telephone,

but missed there, but got him a little later and we discussed it again by telephone.

Q. Did Mr. John Marshall talk to you about any plans that Mr. Fleming and Mr. Messick had?

A. John Marshall later on *later on* talked to me about Fleming, and he believed that Fleming had some people that would go into this, and Mr. Fleming had said to him that he thought it ought to be in federal court, but that was considerably later.

[fol. 3608] Q. Up to the time that Mr. Fleming first came on the scene in the way that you have outlined, had anyone connected with the company as attorney or director or as officials—public officials—taken the position that the proceedings ought to be in federal or bankruptcy court and not in the state court?

A. No, nobody ever took that definite position.

Q. In your conferences with the Securities and Exchange Commission had they taken that position?

A. No, no, they had not. They said, "That is a matter for you gentlemen to decide, what your jurisdiction is. We won't advise you on it." I talked that over with Mr. Carver a number of times, and he said, "No, we refuse to advise you the forum you are going to choose." I think it is only fair to say that our state proceeding had been filed. I did see Mr. Schencker a number of times. I used to see him at lunchtime at the Carlton Hotel; and he said, "Well, my thought was this"——

Mr. T. C. Townsend:

Q. Who was that?

A. Mr. Schencker, who is head of one of the departments of the department.

[fol. 3609] Mr. Jaegerman: He is no longer associated with the Securities and Exchange Commission.

The Witness: I know, but what department was it?

Mr. Jaegerman: Investment companies.

The Witness: But that was the most definite thing any SEC man ever said to me. He said, "My thought was that you would have fared better probably under Chapter 10." That was after this other was over. He was interested, and would ask me how we were getting along. I saw him from week to week for several weeks.

Mr. Farmer:

Q. After that Detroit proceedings had the Securities and Exchange Commission kept in very close contact with the Fidelity company?

A. Had the SEC kept in close contact?

Q. Close contact with the company.

A. I feel that they had kept rather in close contact. They went through the various proceedings, the circuit court of appeals, the appeals from the receivership proceedings in the Northern District here, and I had myself advised from time to time how I thought they were getting along, and had during last year sometime gone over there and talked to [fol. 3610] them about the policy of what we thought then might be done of getting these contract holders where the contracts were so much under water to revise their contracts and cancel out a lot of their claims. One series, for instance, we had only about a thousand contract holders and thought then that they could contact them and get them to revise their contract. I talked that over with them.

Q. You say revise their contracts——

A. I say they talked that. That was one plan we talked about putting into effect.

Q. After the Detroit proceeding did Mr. Jackson and other accountants or auditors stay down at Wheeling for some time? Do you know whether or not that is true?

A. Well, for two or three months I would say it was. But I don't think it was all on Fidelity. I think they were in that district on other matters, and were keeping in touch with Fidelity. I gathered that from conversations, that they would keep in touch with a case for some time after it looked like it was over.

Q. In your experience in handling reorganization matters and in the study that you have made of it and the contracts that you have had and talking over reorganization of this [fol. 3611] company and other companies with persons having experience, have you found out whether or not in a reorganization of a company of this kind, or insurance company, that the speed with which the reorganization is handled is essential?

A. It is at least very advantageous.

Q. That is, I am talking about what is the effect of pro-

tracted litigation on policy holders or contract holders as to whether or not they will keep up their payments?

A. Well, they usually don't keep them up, of course.

Q. State whether or not in taking over companies, reinsuring companies, it is an accepted fact among insurance circles that those policy holders that have ceased for some length of time to make payments and have dropped out, so to speak, are disregarded as being of any value as an asset?

A. I am not an insurance man. I don't know that I would be qualified on that, but I will say this, with all these people with whom I talked, these bankers, they regarded the live contracts as the real assets of the situation rather than the [fol. 3612] ones who had ceased paying. If that is an indirect answer to your question——

Mr. Farmer: Yes, sir, I believe that is all.

The Court: Before cross-examination of Mr. Koontz is started we will take a short recess, and reconvene at twenty minutes after three.

(At 3:06 P. M., a recess was taken until 3:20 P. M.)

After Recess 3:20 P. M.

Mr. Farmer: If your Honor please, I have one more question I want to ask the witness, the main question I subpoenaed him here about.

The Court: I don't want to prevent you from asking the main question, so go ahead.

Mr. Farmer:

Q. That is this, Mr. Koontz: Mr. A. L. King testified that he got the impression from talking with you and Mr. Foulk casually that the company would perhaps have to go through the federal court with your plan—go to the federal court with your plan worked out as far as you could get it in the other court or with the state department. In other words, he said his impression from talking with you and Mr. Foulk was that eventually you would have to go into the federal court. Did you advise Mr. King to that effect or [fol. 3613] make such statement to him?

A. No, I did not. The only discussion about that that I remember was a general discussion that after this proceeding was filed here we would probably have proceedings in various places both in state courts and federal courts

over the country; that there would probably be a lot of suits, like there was before when there was a suit in Michigan and then receivership in the Northern District of West Virginia and various suits over the country. We talked about various suits being filed, but never the main proceeding in another court.

Q. In your negotiations with these different men and houses and financiers and bankers throughout the country, as you have detailed throughout the years 1939 and 1940, did you endeavor at all times to give them the true and Fidelity?

A. Oh, yes, insofar as I was able to I gave it to them, and then invited them to take the audited reports; and the ones of them who got down and worked on it seriously sent their men to the head office at Wheeling and made audits of their own and checked audits that they had and [fol. 3614] so on. I attempted in no way to conceal any facts, and if I had I couldn't, because they were all business houses and made their own audits really, most of them.

Q. State whether or not the principal officers of the company are men that have been with the company over quite a period of years, a number of years, and have more or less grown up with Fidelity?

A. Mr. Risley, who has been president until lately, is probably one of the oldest members, yes. He has been there, I think, probably twenty or twenty-five years.

Q. Longer than Mr. Messick?

A. Yes, Mr. Messick has been there only since last year sometime.

Q. These other men, the officers or heads of departments, they, of course, feel a great disappointment in the fact that Fidelity had to fail, do they not?

A. They certainly do.

Q. And they have hoped—have always expressed hope that in some way there could be some reorganization of the company?

[fol. 3615] A. Yes, sir.

Q. Is that sort of their attitude?

A. Yes, sir.

Mr. Farmer: That is all.

The Court: Who wants to cross-examine Mr. Koontz?

Mr. T. C. Townsend: Your Honor, I would like to ask a few questions.

The Court: All right; go ahead.

Mr. Lauritzen: If the Court please, before Mr. Townsend starts his cross-examination, this morning it was suggested that the State of Wisconsin had no interest in Mr. Townsend's matters in this Court relating to the administrative conduct of this estate. I wish to renew my objection to Mr. Townsend conducting a cross-examination on this issue.

The Court: Overruled.

Mr. T. C. Townsend: I think my position will be clear before I get through. At least, I hope so.

Cross-examination.

By Mr. T. C. Townsend:

Q. Mr. Koontz, how long were you connected with Fidelity?

[fol. 3616] A. I think it was in 1932 and went out as a director in the early part of 1940.

Q. Do you know what time in 1940?

A. Not later than the middle of the year, probably a little earlier. As I remember, I resigned and they asked me to permit them not to accept the resignation for a few weeks. That is merely from memory. I think the minutes should show that. I have never seen them.

Q. How did you happen to become connected with Fidelity at all?

A. As I stated on the main examination, I did this piece of work for them, and I was asked by Scandrett and Marshall to become associated with them, and I refused the request, and a little later they made me a director and renewed the request, and I became connected with them; by invitation I became connected with them.

Q. Then you were a director from the time you became connected with Fidelity until 1940?

A. That is right.

Q. How many shares of stock did you own at any one time in Fidelity?

A. One was assigned to me as a qualifying share; that [fol. 3617] is all.

Q. And you never owned to exceed one?

A. Never owned—never paid for that; that was assigned to me. It was a qualifying share only.

Q. As a matter of fact, you were a director of the company from April 15, 1932, to June 30, 1940? Is that correct?

A. I accept your dates, yes, sir. I don't know that it is incorrect.

Q. And you were a vice-president of the company from April 28, 1933 to April 27, 1934.

A. I don't think I was, sir. They elected me vice-president once, and I refused to accept it.

Q. Well, you mean, then, that you did not actively serve?

A. That is right, yes, sir. I didn't know that it was—I was asked to serve as vice-president and said no—I didn't know if I——

Q. You were placed on the investment committee on September 18, 1934, and served till June 18, 1940? Is that correct?

A. I accept your dates. I don't remember.

[fol. 3618] Q. And you served on the executive committee during the years 1932, 1933, 1934, 1935, 1936, 1937, 1938 and 1939?

A. I accept the dates, yes, sir.

Q. And you were selected special attorney, that is, your firm of Koontz, Hurlbutt & Revercomb, in 1933, and you served during that year and for 1934, 1935, 1936 and 1937?

A. All right.

Q. And then the firm name appears as Koontz & Hurlbatt and you served with that firm in that capacity for the company for 1938? Is that right?

A. That is right.

Q. And then Koontz & Koontz served as special attorneys for the company for 1939, 1940 and 1941?

A. That is right.

Q. Up until the time it went into the hands of the receivers?

A. Yes.

Q. Did you ever resign as special counsel at any time?

A. No.

[fol. 3619] Q. Then your relationship as special counsel was terminated by action of the court in 1941, that is, the state court receivership?

A. Yes.

Q. If it was terminated at all.

A. If it is terminated——

Q. It may still be going on. I don't know.

A. Well, the compensation is not going on, so I assume our relationship is not going on.

Q. If you owned no stock in the company or your stock was limited to one share during those ten years, what was your real interest in the company?

A. My real interest in the company was upon request of these gentlemen to help them build the company up, rehabilitate the portfolio——

Q. Was it in bad shape when you went with it in 1932?

A. Yes, sir, it was.

Q. And it was your special interest, then, after you went with the company to rehabilitate it and build it up?

A. Was to help rehabilitate it and build it up, yes, sir. [fol. 3620] At the same time, I was getting a monthly stipend, as I remember, Mr. Townsend.

Q. I was just going to ask you something about that. I wondered if you were.

(Witness laughs.)

Q. I am going to ask you this particular question, and you can break it down, if you please, if you can't answer it as a whole. What was the total compensation you received from Fidelity during the time you were connected with it from 1932 to 1941?

Mr. Palmer: If your Honor please, I fail to see the relevancy of anything in connection with the trustee to this hearing in that matter, and therefore I object to it.

The Court: Overruled.

Mr. T. C. Townsend: I think the relevancy will appear, your Honor, otherwise I would not ask these questions.

The Court: I overruled the objection.

Mr. T. C. Townsend: Go ahead and answer.

A. I don't know exactly what it was. I have understood that some figures have been submitted here that lead into [fol. 3621] eighty-some thousand dollars. I have no reason to feel that those figures are not correct.

Mr. T. C. Townsend:

Q. That $80,000 didn't cover this ten year period. I am asking you for the total compensation you received for the ten year period, if you know?

A. I do not know, sir. I did not receive any very substantial fees; I received $200 per month; no large fees of any kind up until the SEC proceeding.

Q. Now, Mr. Koontz, in what litigation was the company engaged while you were its attorney, special or otherwise?

A. Very little; a few cases here. People would sue the company on contracts trying to get back their payments with interest; and we went to Ohio at one time to meet with the Commissioner, and I think probably two trips two of us were over there—just advised generally. I don't know—there were not very many suits.

Q. Well, you did have some litigation pending in the courts in the several states, did you not?

A. Not that we handled, sir, or were responsible for.

Q. I don't know who was responsible for if, but you had [fol. 3622] to have—you did have litigation that you were called upon to take a part in.

A. You mean Fidelity as a company?

Q. When I say "you" I mean Fidelity, unless I say otherwise, or I can use the term Fidelity.

A. I don't—I don't remember that we had any very important litigation between the time I went on as a director and the SEC litigation.

Q. My question would include the SEC litigation. You did have the litigation in Michigan in 1938.

A. Oh, yes, that is true, getting up into 1938, yes.

Q. And you had litigation in the Northern District of West Virginia?

A. That is true.

Q. When was that?

A. That was in the early part of 1939.

Q. And that litigation was conducted in the District Court for the Northern District of West Virginia, and ultimately in the Circuit Court of Appeals for the Fourth Circuit?

A. That is true.

Q. And the litigation in Michigan ended in the District [fol. 3623] Court for the Eastern District of Michigan?

A. That is true.

Q. Do you recall any other suits that Fidelity had in the courts of any magnitude that you were called upon either to defend or prosecute?

A. Well, in connection with this—or at the same time that this receivership proceeding was filed in the Northern District of West Virginia, various proceedings were filed elsewhere. For instance, there was a proceeding in Pennsylvania, there was a proceeding in Indiana. Some suit of some kind against the directors over in Cleveland.

Q. All right, let's take the suits in the Northern District of West Virginia. What particular part did you take in that, in conducting that litigation in the Northern District? Any?

A. I was there day and night except for one or two days that I went to Detroit.

Q. I mean, what did you do in that litigation?

A. Well, my firm was responsible—largely responsible for that. Goldsmith did the arguing before the Court. [fol. 3624] Local counsel were, in addition to Mr. Foulk, Mr. Wood.

Q. Did you do any yourself?

A. Very, very little.

Q. You didn't appear in court in connection with it——

A. Oh, yes.

Q. You appeared in court, but you took no part in the court proceedings? That is what I mean.

A. You mean in arguing the case?

Q. You didn't argue it?

A. I didn't argue the case, no, sir.

Mr. Palmer: If your Honor please, I am going to renew my objection. Mr. Townsend has not yet disclosed any relevancy of the questions to the present proceedings and whether they are brought in good faith or not. I think even Mr. Townsend, representing the trustee, should be limited in his examination to the scope of these issues.

The Court: I have indicated that my view is that the connection of Mr. Koontz or his firm is relevant on the issue which may arise under sub-section 4 of Section 146——

Mr. T. C. Townsend: Your Honor, that is the reason for my taking part in this examination. If your Honor thinks [fol. 3625] these questions are not relevant to that particu-

lar question, or won't lead to that particular question, I am entirely willing to abandon them.

The Court: It seems to me that they are relevant.

Mr. T. C. Townsend: That is what I thought.

Mr. Palmer: Your Honor, may I ask what right the trustee and its counsel, who are supposedly disinterested parties, have to attempt to uphold the good faith of the debtor in filing the petition? That would immediately disqualify the trustee and its counsel from being disinterested. The statute requires the trustee and its counsel to be disinterested on the question of whether the debtor's petition is filed in good faith, and if counsel for the trustee or the trustee becomes interested in it, they immediately become interested and should be disqualified by the Court.

The Court: I have overruled the objection.

Mr. T. C. Townsend:

Q. Did you argue it in the Circuit Court of Appeals?

A. No.

Q. You did not go down there?

A. No.

[fol. 3626] Q. You did not prepare a brief?

A. No.

Q. You did not prepare a brief in the state court?

A. My firm did.

Q. I am trying to find out what you did.

A. Well, I—(witness laughs.)

Q. Not your firm; I want to know what service you rendered.

A. Well——

Q. The only services rendered in the litigation in the Northern District of West Virginia and the Circuit Court of Appeals in connection with that case were rendered by your firm, and not yourself individually? Is that a correct statement or not?

A. No, sir, it is not, because I took part in conference day and night with the District Court——

Q. Then I will put it this way: the services you did render in that litigation was in the way of conferences among counsel?

A. That is right.

Q. Does that same thing apply to the litigation in Michi-

gan? If so, you will save me from asking a number ques- [fol. 3627] tions.

(No answer.)

Q. That is, the only way you took part in the litigation in Michigan was by conferring with other counsel that were conducting the litigation for Fidelity? Is that right?

A. No, the Michigan situation was handled primarily in Washington in the SEC offices, where we did confer, and got an agreed order or judgmnet before we went to Michigan. Then we had a local representative that appeared in Court in Michigan on one side, and Mr. Jaegerman and Mr. Lane on the other side, the day that order was entered.

Q. And the only appearance in that court was for the purpose of entering that final order, by anybody.

A. That is true at that time. Later on, when some literature was sent out that the SEC criticized, I went to Michigan and met Mr. Lane there, and we appeared before the court in chambers relative to that, the propriety of sending out a pamphlet, and a discussion of what could properly be sent out.

Q. You stated in your examination in chief that you spent [fol. 3628] a good deal of effort and time in trying to interest financiers in furnishing money to rehabilitate Fidelity. That is correct, is it?

A. That is correct.

Q. When did you first decide, in your own mind, or by reason of conferences with others, that Fidelity was in need of rehabilitation?

A. We were convinced by the SEC proceeding that we could proceed much more smoothly with a buildup of our general structure.

Q. What situation presented itself to you when you first became connected with the company in 1932? What was its condition then?

A. The condition then was that it was under water quite a bit.

The Court: You mean it was insolvent?

A. I meant—I think on an overall basis it was insolvent. They were selling then this B contract, which they provided a special deposit back of, so that the actual contract they were selling was not insolvent, but on an overall basis I

think it was insolvent, that is, adding all of the obligations together and all of the assets of the company together. [fol. 3629] On a market basis it certainly was.

Q. Did it ever get out of that condition?

A. I think so. It was supposed to be out of that about 1936 or 1937. It was 1937, I believe, they claimed to have made a very substantial amount of money.

Q. Then when did you find out it had got back in, if you did find out?

A. Well, these gentlemen from the SEC analyzed this whole situation and claimed that we must make representations to the public on the exact standing of all these contracts outstanding, rather than make an overall statement and add all assets and all liabilities together. No matter if you appeared solvent by that kind of statement you still were not justified in doing business with that sort of statement; and when you broke your statement down into the contracts and what was back of those contracts some of them showed in red. So they felt they needed capital at that time—was to get enough capital in your common stock account to show that you had enough to meet your payments on all of your contracts.

Mr. T. C. Townsend: Let me see if I understand you. [fol. 3630] Do I understand you to say that when you went with the company in 1932 in your opinion it was insolvent?

A. On a market basis it probably was, yes—on a market quotation basis.

Q. You mean if you valued the securities——

A. At their quotation on the market.

Q. Quoted market value.

A. That is right. Of course, the statement of the company did not show it was insolvent by any means. They left the securities on the books at appraised value, purchase value or whatnot. The statement did not show insolvency.

Q. If it was insolvent in 1932, when you first became connected with it as a member of the board of directors, what did you do about it?

A. We attempted to make money and to keep on running until your market quotations went on back up, like all other institutions.

Q. Did you feel at that time that you needed any new capital?

A. We certainly felt we would like to get new capital.

Q. Did you make an investigation of Fidelity after you [fol. 3631] became connected with it to find out some of the reasons why it was insolvent?

A. No, I graduâlly learned some facts about it, that they had sold securities on the way down, as the market went down, and they kept getting harder up and harder up and were not able to replace those securities in the portfolio.

Q. Is that the only thing you learned with reference to its condition, that it sold stocks on a declining market?

A. Well, stocks and bonds. I learned it had some very substantial losses, too, on some post office bonds—I think that was the biggest loss it had—something that had been purchased some few years before.

Q. Well then, it was your opinion after you made an investigation that when you became connected with the company its condition was due very largely, if not altogether, to the fact that it had sold securities on a declining market? Is that true?

Mr. Palmer: Your Honor, I object to the use of the words "after he made an investigation." The witness has not said he made an investigation. He said he learned [fol. 3632] things slowly. He never investigated.

The Court: I think that is correct. The question may be revised to conform.

Mr. T. C. Townsend: I didn't get the Court's ruling.

The Court: Mr. Palmer is correct. The witness didn't say he made an investigation when he came in.

Mr. T. C. Townsend:

Q. When you became connected with the company in 1932, did you ever make an investigation to determine what its financial condition was?

A. No, I merely looked at the statement furnished.

Q. What sort of statement?

A. They had, as I remember, Ernst & Ernst for the auditors at that time. They would have a statement at the end of each year. A little later on one of the nationally known auditing firms audited the company for

a year or two; and I just accepted those statements at face value.

Q. That is the only investigation you made?

A. That is true.

Q. How did you find out about these falling securities?

A. That comes out from time to time in discussion or [fol. 3633] directors' meetings.

Q. That was an investigation, wasn't it, to that extent?

A. Well——

Q. If it wasn't an investigation, it was knowledge.

A. I was gradually getting knowledge, yes, sir.

Q. Then you began to get knowledge by reason of these falling securities that the company was in bad condition?

A. Based on a market value, yes.

Q. And after you received this knowledge, your opinion was and your conclusion was that it was in bad condition because of the falling market? Is that correct?

A. That is correct. Market-wise it was in bad condition, yes, sir.

Q. And no other reason. You attributed to that falling market bringing about of the financial situation with reference to Fidelity? Is that right?

A. I think that was the main item. There may have been some mismanagement in prior years. I don't know about that.

Q. Did you investigate to find out?

[fol. 3634] A. We tried to build up management. Got a man by the name of Pole, who was comptroller of the company, go in as president. At all directors' meetings we were talking about what we should do to become stronger, both in management and assets.

Q. I understood you to say you learned that there had been some prior mismanagement.

A. No, I said there might have been.

Q. Well, was there, prior to the time you became connected with it?

A. There may have been?

Q. Well, was there?

(Witness laughs.)

Q. You can answer that, Mr, Koontz.

Mr. Palmer: If your Honor please, if the trustee is finding that out for the purpose of its 167 report, the books of the company are open to it and it can investigate it

just as easily as Mr. Koontz could. If they are asking it for any other purpose it is an improper question.

The Court: Overruled.

Mr. T. C. Townsend: Answer the question, if you can.

[fol. 3635] A. Well, according to my ideas there had been some loose management.

Q. Well, all right; what was it?

A. For instance, the sales agency.

Q. Well, that was what?

A. I thought had been spending too much money; were in debt to the company.

Q. Anything else besides the sales agency?

A. That was—stuck out like a sore thumb. I am not so sure about——

Q. Well, were there any fingers sore next to the thumb that you discovered?

A. I do not——

Q. Or that stuck out——

The Court: Mr. Townsend, if you would let this witness answer instead of interrupting him——

Mr. T. C. Townsend: Your Honor, I did not mean to do that. He had not started to answer.

A. When I first knew about the company they had a part time president of the company, Mr. Burt, who was on for a very nominal salary as a part time president. The company was really being run by a vice-president. [fols. 3636-3641] That didn't look like good management. Later on that was changed, as I say, by taking Mr. Pole as president and asking to get in anybody he wanted to build up his management, and he is the one that first brought in his securities man to keep tab on the portfolio.

. . . . . .

[fol. 3642] Mr. Palmer: During the cross-examination of Mr. Marshall last Saturday morning I attempted to ask him the same or similar questions along the same lines, and the Court ruled at that time that the Court was not interested in whether the company had been mismanaged because he would not have anyone that had had anything to do with the mismanagement have anything to do with the company in the future, and therefore the questions were irrelevant. I am suggesting that to the Court because I

believe these questions are along the same line as those I asked Mr. Marshall which were excluded upon objection of the trustee and debtor.

The Court: I thought I clearly explained my reason for admitting evidence of Mr. Koontz's conection with Fidelity, but I will restate it. Under Section 146, sub-paragraph 4, one of the questions to be decided in determining whether a petition is filed in good faith is whether there is a prior proceeding pending in any court and it appears that the interests of creditors and stockholders would be best sub-
[fol. 3643] served in such prior proceeding. Now, there is a proceeding pending in the Circuit Court of Kanawha County, West Virginia, and Mr. Ross Thomas, of the firm of Koontz & Koontz, has been appointed one of the receivers; and I am of opinion that any evidence of the connection of Mr. Koontz or Mr. Thomas or any member of the firm or associate of the firm of Koontz & Koontz with the affairs of Fidelity prior to that appointment of those receivers is of some pertinency in determining that question, and therefore I have ruled that that testimony is admissible, and I adhere to that ruling. Of course, a different situation was presented when the questions were asked of Mr. Marshall's connection.

Mr. Palmer: If your Honor please, may I ask the Court to clear this up, which I think you did yesterday. The questions were not as to the ability of Mr. Thomas, but as to his suitability, I believe the Court said?

The Court: That is correct, yes.

Mr. Palmer: I have this thought in mind, your Honor, that the suitability would be dependent upon the question of whether or not there was a possibility of any wrong-
[fol. 3644] fulness going on, that that would be entirely under the judge of that court as to the compensation and guidance and so forth of that receiver.

The Court: Well, I don't so perceive it. I think the decision under Section 146 is entirely the responsibility of this Court and not of another court; and although some other court may feel that a prior proceeding that is now pending would be for the best interests of creditors and stockholders, this Court must examine into that and determine for itself whether that is a fact or not a fact.

Mr. Palmer: I agree with your Honor on that, but the point in mind that I couldn't see was this, that in state

court proceedings there is no law or intimation of any law that a person representing a debtor who goes into receivership cannot be one of the receivers. In fact, as this Court knows, that is a very common practice. In federal court there is a direct law against that. Now, the only way that I can see the relevancy of that is that the Court would be attempting to apply the federal rule to the state court.

The Court: I am not applying any rules to the state [fols. 3645-3664] court.

Mr. Palmer: May I have an exception to the Court's ruling? Perhaps I did not make an objection at the time I was asking the questions.

. . . . . .

[fol. 3665] The Court: Let's see if we can get at the thing that the Court thinks is the only material phase of this in this way. In setting up an appraised valuation for the trust certificates of Marston Company and Paull Company, was the obligation of National Sales Agency treated as having any value, and if so, what percentage of its face value?

Mr. T. C. Townsend: That is a question to the witness, I understand.

[fol. 3666] The Court: That is right.

A. I don't know what percentage, your Honor. I remember this, that when the sales organization was taken over, various statements were made as to the cost of building up a sales agency and that we were getting this for nothing; if we had a million dollars just to pay over to the National Sales and they would pay it back it would clear in that way and wash out, but we didn't have the million dollars to pay, and it was handled the other way. We were told that there was actual value back of the sales force that was taken over. Thereafter interest was paid on this note and some reductions made from time to time.

The Court:

Q. Well, was it given any value, if you know, in the appraisal of the Marston and Paull Company securities?

A. I think it was given some value, yes, sir. I remember it was questionable what the value was; there was quite a large insurance policy that was collateral on that note, and the company carried that for some time. That had a cash value.

Q. How much, if you know?

[fol. 3667] A. I don't know. That is in the record somewhere.

Q. What other assets, if any, were behind it to give it a value other than this consideration that Mr. Palmer spoke about?

A. Only the value of the building up of the organization—the sales organization.

Q. That would not enter into any appraisal of the worth of it in the hands of Marston Company and Paull Company, would it, as securities of those companies?

A. Well, you were in this position, having taken that over, it was built up at quite a cost. You could have foreclosed and taken it over and not given it any value, or you could keep your books the other way.

Q. I am not speaking now of its value in the hands of Fidelity, but I mean do you know of any way that that would add to its value as a security in the hands of some state depository securing contract holders?

A. It would be hard to appraise that as a value of $750,000, although over a period of years it might be paid off with interest, if I may answer it in that way; because that is exactly the way it was handled; it was reduced so much each year, interest paid on the note and it was to be reduced [fol. 3668] from time to time. Of course, it is valueless if you are not a going concern and can't use the asset that was taken over.

The Court: Are there any other questions, Mr. Townsend?

Mr. T. C. Townsend: Not on that point. If Mr. Jaegerman wants to ask a question on it, I think now is the time to do it.

The Court: All right, Mr. Jaegerman.

Cross-examination.

By Mr. Jaegerman:

Q. Isn't it true, Mr. Koontz, that these National Sales Agency notes amounting to a million dollars resulted from advances by Fidelity to National Sales Agency?

A. Isn't it true that this amount represented by the note resulted from advances?

Q. Yes.

A. I understand so.

Q. And these advances came from the Fidelity general fund? Isn't that so?

A. They were supposed to, yes, sir. As far as I know [fols. 3669] they did.

Q. But the general fund, not having enough money, sold or transferred these notes to two of the contract funds, the income fund and the annuity fund? Isn't that right?

A. I don't know. I don't say it is not right. I just don't remember the answer.

Q. So that a condition resulted where the National Sales note, if it were an asset, was an asset held by two contract funds? Isn't that right?

A. Well, it may have been. I am saying I don't remember what those transactions were.

Q. And as National Sales Agency notes they were not depositable with any state against contract liability for the income or annuity contract? Isn't that right?

A. Well, I don't know. I don't think they would qualify as deposits, if that is what you mean. Is that what you mean?

Q. Yes. When they were converted into Paull and Marston bonds, the bonds, in turn, were transferred to the contract funds, the income and annuity funds, were they not? [fol. 3670] A. Well, I assume they were.

Q. And isn't it true that the only state that would accept them for deposit was the State of West Virginia?

A. I don't know. I understood West Virginia accepted most of them. I don't know.

Q. Did any other state accept them?

A. I don't know whether they were accepted anywhere else or not.

Q. Isn't it true that for deposit——

A. I don't know whether they were tried anywhere else or not.

Q. Do you know that they were tried anywhere else?

A. No, I say I don't know that they were tried.

Q. Are you familiar with the Craigin Morris valuation?

A. Generally, yes.

Q. What were those Craigin Morris valuations?

A. Craigin was a real estate man from Cleveland who had worked for the Insurance Department of the State of Ohio, and he was recommended to Colonel Thompson, who was from Ohio, as a man who knew real estate valuations,

and he put him on these real estate holdings of this company and asked him to evaluate them.

[fol. 3671] Q. And the deposited value of the Paull and Marston bonds was determined on the basis of the Craigin Morris valuation, was it not?

A. I think so, where they were available. If not, some other yardstick was used.

Q. And didn't the Craigin Morris valuation accept at full face value the notes of the National Sales Agency?

A. I don't remember about that, Mr. Jaegerman. I am not evading; I just don't remember whether they accepted that note at full face value or not. As I remember, they did. As I remember, that note was in there at full face value and was reduced from time to time.

Q. And on the basis of the statements by certain officers and directors of Fidelity to Craigin Morris that the interest was paid on these notes, Craigin Morris accepted the notes of the National Sales Agency at the full face value?

A. That is true.

Mr. Jaegerman: That is all on this point, your Honor.

The Court: All right.

[fol. 3672] Cross-examination (Resumed).

By Mr. T. C. Townsend:

Q. Mr. Koontz, at the time you went on the board of directors of Fidelity, did you find anything with reference to what has been referred to here as interfund loans?

A. Not for some time. If I did, it didn't impress me as to what it was.

Q. Well, did you finally find out?

A. Yes, I finally found out.

Q. How long had you been on the board?

A. I don't remember, sir.

Q. What were those interfund loans?

A. Well, when one fund would be in excellent shape and another fund would need some advances, there would be an intefund loan to take care of the one that needed the advances.

Q. Take it from the good fund and transfer it to the bad one?

A. That is right.

Q. And authority for doing that under the contracts that you sold?

[fol. 3673] Mr. Palmer: Objection, your Honor.

The Court: That is a legal conclusion. I sustain the objection.

Mr. T. C. Townsend:

Q. When these various series contracts were sold, did you set up separate funds for each one of them?

A. I didn't come on until after most of these contracts had been sold. The B contract was the one I was familiar with. It says specifically that there should be a contract fund set up and maintained for that. There was always a question and some argument about whether separate *contracts* should be kept for the other.

Q. The books of the company did show that a separate fund had been set up for each contract?

A. I think they kept the books on that basis.

Q. But in practice, so far as the funds were concerned, they were not carried out according to the bookkeeping system? Is that correct?

A. I think that is correct, yes, sir.

Q. In other words, you didn't keep these funds separated as a matter of fact?

A. They were deposited, as I remember—the securities [fol. 3674] were deposited all in one vault, or one box in the vault, instead of being kept separated, although they were kept on the company's books separate and distinct.

Q. Did you think it was a good practice to take the funds—take the money from a solvent fund and lend it to a fund that was insolvent?

Mr. Palmer: Objection.

The Court: Sustained.

Mr. T. C. Townsend:

Q. Well, was that done? Did Fidelity use the money from solvent funds and lend it to insolvent funds?

A. I don't know about funds being insolvent at the time, and those interfund transfers, Mr. Townsend, they did transfer from one fund to another—had some interfund loans.

Q. Well, why did they do that?

A. I don't know all the reasons, but I know one reason was if one fund needed some money at a particular time and did not want to cash in some of its own securities or might have been short on securities at the time, the other fund would lend it some money. Remember, your common [fol. 3675] fund was back of and was a cushion for all these funds. If that were in shape to take care of it, the transaction would have been a cleaner transaction if the transfer had been made from the common fund into these funds rather than one fund to another, but so long as that fund was enough to take care of any advance or transfer I think your transaction was all right.

Q. How long was this system of interfund loans carried on? Until December 3, 1938, wasn't it?

A. Yes, sir.

Q. An then it was stopped.

A. By the SEC. That was part of the injunction.

Q. I am going to pass that over and ask you something else. I want to get through if I can. Mr. Koontz, when did it first occur to you—I am talking to you now, not to Fidelity—when did it first occur to you as attorney for Fidelity or in the capacity of a member of the board that it was necessary to have some sort of court proceedings to continue Fidelity in any capacity?

A. Well, Mr. Sims made some very strong suggestions very early in this year.

Q. He wrote you a letter——

[fol. 3676] A. Wrote me the letter in March, but he had made suggestions even before that, by telephone and face to face.

Q. Well, I am going to keep it as short as I can. You did confer with Sims?

A. Yes, sir.

Q. Was the situation discussed by the board?

A. Well, I wasn't a board member and wasn't at their meetings. It was discussed with the officers of the company from time to time.

Q. Was the situation of the company discussed with the attorneys of the company—special attorney—discussed with you?

A. The situation was discussed between Mr. Sims and me, yes, and I, in turn, discussed it with Mr. Foulk, who

is the general attorney inside the company, and with Mr. Marshall, who was chief counsel for the company.

Q. But you were special attorney?

A. Yes. I didn't know I was named as special attorney. I thought I was kind of local-attorney here.

Q. You were pretty active, weren't you?

A. Fairly so.

[fol. 3677] Did you discuss the matter with the SEC, the condition of Fidelity?

A. Yes, yes.

Q. Was that at the March 17th meeting?

A. Well, we did discuss that at that time.

Q. Well, did you discuss it at the March 17th meeting?

A. That is right; that is right, yes, sir.

Q. Was there any discussion at that time as to which court the proceedings should be begun in?

A. Yes, sir, questions were asked between and among us as to what forum should be chosen for this.

Q. What court did you prefer?

A. I had no preference. I had concluded, and so expressed myself—I am not sure whether it was at that meeting, but it was to Mr. Kline, and I think before that maybe, I preferred either the local court here, because of the statutes naming it, or the federal court in the Northern District, where the chief office of the company was located. Those were the two courts discussed most in connection with this.

Q. That was discussed at this meeting——

A. No, I am not sure that that was discussed in open [fol. 3678] meeting now.

Q. I am talking about this meeting of March 17th, when Mr. Jaegerman was present and other persons representing the SEC.

A. The general discussion then was limited, as I remember, as to whether it be state or federal; no particular court; just the two classes of courts.

Q. Did you express yourself at that meeting?

A. I don't believe I did. I am not sure.

Q. Did you have a preference when you were discussing it?

A. No, not at that time I didn't.

Q. That was the purpose of the meeting, was it not, to determine what sort of court proceedings should be instituted?

A. No, not necessarily. I think we discussed whether or not we might still go ahead and reorganize this company outside a court proceeding.

Q. But you concluded you couldn't do that?

A. No, No, Mr. Townsend, we did not. No, no, we discussed cutting down——

Q. I know you discussed that.

[fol. 3679] A. We discussed that, and my memory has been refreshed since I have been here and have another week to do some more work on it, to try to put our men out and ask the contract holders to cut down their claims on contracts and still go on through reorganization outside any court.

Q. In addition to discussing the question of reorganization, you did discuss the question of instituting court proceedings? That is true?

A. Yes, at some of these times very shortly unless something was done outside by way of reorganization it would be necessary.

Q. A general discussion of the advisability of going into court took place at your March 17th meeting? Isn't that true?

A. Well, we discussed court proceedings. I wouldn't say it was the main part of the discussion by any means.

Q. I didn't say it was the main part, but I said it was discussed at that meeting.

A. Well——

Q. Did you discuss particular courts, that is whether it [fol. 3680] should be in the state court or the federal court?

A. We discussed among ourselves whether it should be in state court or federal court.

Q. What do you mean by "among yourselves"?

A. The lawyers, on the side. Most of the discussion I remember was after the meeting broke up, and some of us, Mr. Jaegerman included, were standing over at the side discussing this.

Q. Was that a discussion with reference to what court the proceedings should be instituted in?

A. Well, some proceeding, yes.

Q. What was the result of that?

A. No conclusion reached on their part or our part either. Mr. Carver was there and some of Mr. Jaegerman's associates. My understanding was there was no definite con-

clusion on their part as to where proceedings should be filed, if it were filed, by the company.

Q. Did you express your preference at that meeting?

A. I don't think so.

Q. Did Mr. Jaegerman express his?

A. I am not sure that he did.

Q. Did anybody express their preference as to where [fol. 3681] the proceedings should be?

A. Somebody said this, that "I would think, with a general situation like this, it would demand federal procedure" —some expression of opinion like that.

Q. Do you remember who made that statement?

Mr. Palmer: Let him finish his answer.

Mr. T. C. Townsend: I thought he had finished.

A. Oh, no, I don't remember who it was. As I remember, I talked to Mr. Carver, of Mr. Schencker's department, more about this jurisdiction question than anybody else. He said, "No, we don't want to be put in position of advising you what your forum is to be; we don't know." We discussed both angles of this thing, and Mr. Kline expressed the same opinion.

Q. In your discussions with Mr. Carver and Mr. Kline, did you discuss the advantages or disadvantages of state and federal proceedings, respectively?

A. I discussed with Mr. Kline the terms of our statute and talked to him about a plan of reorganization, and he agreed that he would put me in touch with the reorganization division of the SEC and have them help work out something at any time I was ready to proceed, if we went [fol. 3682] that way. If we went the other way, they would come in automatically.

Q. What do you mean "the other way"?

A. If we went into a federal court. As I understand, it is automatic for you to come in, Mr. Jaegerman, if we are in a federal court; and they were to assist the other way, if we went the other way.

Q. After you had this discussion on March 17th and near that time, did you attend any meeting of the board of directors of the association?

A. No, I didn't.

Q. When was this state court proceedings decided upon?

A. This letter was addressed to me dated March 25, wasn't it? We had a number of conferences shortly there-

after. My advice was it was a separate proceeding in the state court, under our state statute. I talked to Mr. Partlow, as I said a while ago; I talked to my own associates, talked to Mr. Sims a number of times.

Q. Mr. Sims, in his letter to you of March 17th—or 25—says this in effect, "I should like to explore the possibility of placing this company in trusteeship under 77B." "Inas- [fol. 3683] much as you have acted for this company in a legal capacity for several years, I wish you would consider the observations made herein." Did you make any reply to Mr. Sims in reference to instituting a proceeding in federal court?

A. Under 77B?

Q. Of course, 77B was repealed at that time. Did you reply to that feature of his letter?

A. I did personally, yes, sir.

Q. What did you tell him?

A. After I made further investigation there I told him I thought the simplest procedure would be in the State of West Virginia.

Q. Why?

A. And the proper procedure.

Q. How did you reach that conclusion in preference to a federal court proceeding?

A. All right, sir. In the first place, the statute recites that he may proceed in the Circuit Court of Kanawha County. This was some of the reasoning, not only mine, but some other people I talked to in connection with this, Mr. Foulk, to be specific. In the old days the salesmen [fol. 3684] all recited and referred to these various statutes in West Virginia and what protection the people had and son on; so that we felt that these contracts were sold with these statutes as really a part of them, whether they were written into them or not, because they referred to them, and also that that statute probably meant something, and if it meant anything you would read into it a less expense to administer these assets by a state officer in a local court than if you did go in a federal court and get outside, away from your officer who was on a state payroll, than otherwise.

Q. You think, then, it would be more economical to administer this——

A. I certainly do, Mr. Townsend—I do.

Q. Just let me finish my question. You think it would

be more economical to administer this proceeding in a state court than in federal court?

A. In case of liquidation I certainly do.

Q. I am not talking about liquidation.

A. All right.

Q. Talk about anything you want to.

A. Then, going to the other side, about reorganizing, this was our reasoning on that, that no reorganization could be [fol. 3685] successful without the co-operation and assistance of our own Insurance Commissioner and some of the other insurance commissioners.

Q. You thought you could get them to—then it was a voluntary matter in the state court?

A. We would get those insurance commissioners sold on a plan and get before the state court and you would have a better chance to reorganize than anywhere else.

Q. And it would be entirely a voluntary matter in the other states outside West Virginia?

A. Yes, or you might have some ancillary proceedings in the other states, but we didn't see how you would have any chance to reorganize this—we talked about how we would get these securities in from the other states—if we could get them in—whether or not you could get a plan approved by the commissioners more quickly in a voluntary way than to bring them into court, and so on. That was talked of at considerable length.

Q. You didn't find any way to get them in, though, did you, the other states?

A. We didn't get to that, sir.

Q. Didn't you——

[fol. 3686] A. We never had a plan of organization.

Q. How?

A. We never got to a plan of reorganization to submit to the Court down here.

Q. You couldn't unless you got control of the assets, could you?

A. Well——

Q. And you did take steps to get in all the assets——

A. We did——

Q. (Continuing.) From the other states?

A. Down to our local court?

A. Yes.

A. I didn't so understand it. Our Insurance Commis-

sioner wired all the other people and asked them to act as receiver for the assets in their respective states.

Q. Didn't you send some representatives of your office to some of these other states to confer with them about coming into this state court proceedings here?

A. No, I did not.

Q. Didn't Mr. Goldsmith go out to Madison, Wisconsin, with reference to that question?

A. He went out with Mr. Messick on some hearing out [fols. 3687-3690] there. I don't know just what the scope of it was.

Q. And didn't you go out to see the Insurance Commissioner or insurance department with reference to bringing the assets into this court?

Mr. Palmer: I think there is no such testimony.

A. Not that I know of.

The Court: I will permit the cross-examination by the question. I agree with Mr. Palmer that there is no testimony to that effect.

* * * * * * *

[fol. 3691] The Court: That ought not to take much time.

There is one other observation I have to make in connection with the ruling that I made yesterday. Mr. Palmer [fol. 3692] made a motion to strike out certain opinion evidence which had been given by Mr. Burt, Mr. Pulfer, Mr. Risley, I think, and perhaps some others. There had been no objection made to this opinion evidence at the time it was received, and at the time Mr. Palmer objected to it yesterday I overruled his objection, and I am still of opinion to overrule the objection, but I want to make this observation in connection with it. The entire testimony of those gentlemen with reference to whom he made his motion is not fresh in the Court's mind. I am of opinion, from my recollection of it, that they qualified to give their opinion. However, if, on a more close perusal of their testimony I conclude that they did not qualify to give their opinions, then those opinions will not be given any weight whatsoever by the Court. I thought I should make that statement in view of my hasty ruling yesterday.

Mr. Palmer: If your Honor please, the reason I made that motion was this. We did not object to the opinion

being given, because, as I stated to the Court, we felt the Court would judge as to the weight which should be given it, having full advantage of their testimony and knowl- [fols. 3693-3694] edge. We felt, though, that Mr. Latta, the witness on the stand, had given his qualifications, and therefore was entitled to give an opinion, but if he were not entitled to then under the same basis the Court should not consider the other testimony, and it was only for that reason we made the motion.

. . . . . .

[fol. 3695] Q. Mr. Koontz, after you received the letter of March 25 from Auditor Sims setting out his views with reference to Fidelity, did you make any written reply to that communication?

A. No, sir, I feel sure that I did not.

Q. Positive of it?

A. I think that is right.

Q. Did you reply to it at all?

A. Yes.

[fol. 3696] Q. In what way?

A. I conferred immediately with Mr. Partlow of the Attorney General's office.

Q. Well, did you confer with Mr. Sims?

A. Well, after that I conferred with him and talked to the various boys around my office and talked to Sims then shortly after that.

Q. You and Mr. Sims held a conference then, after the receipt of this letter?

A. Well, several conferences between the time that letter——

Q. March 25?

A. Yes, I conferred with him a number of times by phone and talked to him personally a number of times between that time and the time of filing the suit.

Q. Of course, in your conversations and conferences with Mr. Sims after the receipt of this letter, you notified and advised him fully with reference to the subject matter of the letter, did you not? Here is the letter, if you want to look at it. (Handing paper to witness.)

A. Thank you. Well, we talked—our conversations were [fol. 3697] on the main subject as to whether or not there should be a proceeding in the state court or the federal Court. That was the general basis of the discussion.

Q. And you advised him to proceed in the state courts rather than in the federal courts?

A. I advised him that I thought that that was the better place to proceed, yes, sir.

Q. Well, you expressed that to him as your best judgment?

A. I did.

Q. And as your legal opinion, that it was best.

A. I advised him definitely, Mr. Townsend, that he could proceed in the Kanawha Circuit Court or the federal district court of northern West Virginia. Those two courts were talked of; and then we talked about the advantages of one over the other and what was the proper one.

Q. I am not talking about a preference between the Northern District and the Southern District. I am just talking about your preference as between federal courts and state courts, and you advised him in favor of state courts?

[fol. 3698] A. I did. I thought it was proper for him to proceed in the state court rather than in the federal courts.

Q. After you had so advised him or between the time of the receipt of that letter and the institution of the suit, did you confer with the officials of Fidelity as their attorney?

A. I conferred a number of times with Mr. Tom Foulk, talked to him by phone, talked to Mr. John Marshall a number of times, yes, sir; I think with Mr. Risley; I am not sure. I talked to two lawyers, however.

Q. Did you give them your views as to a preference between the state and the federal courts?

A. I did; I expressed myself freely to them, as I had before.

Q. And you advised them to the same effect that you advised Sims?

A. Well, yes, sir, that was my conclusion. I let them have my conclusion.

Q. That you thought it was best for all concerned that the suit be instituted in the state courts?

A. That was my advice, yes, sir—to which they agreed, let me add.

[fol. 3699] Q. Then, through your rendering of your legal opinions after Sims had agreed to institute suit in the state court and officers of Fidelity had agreed that that

was the thing to do, you then proceeded to get ready the papers, or your firm did?

A. That is right.

Q. In conjunction with the Attorney General?

A. That is right.

Q. Is that correct?

A. That is true.

Q. And when the bill was filed in the Circuit Court of Kanawha County the Attorney General appeared there representing Sims?

A. That is right.

Q. And you, or your firm, appeared there representing Fidelity?

A. Well, I will say this. Mr. Sims asked—discussed fully after it was agreed that this proceeding should be filed, the question of handling it and so on. We did represent Fidelity in accepting service for Fidelity—represented them to that extent.

Q. Well, as a matter of fact, Mr. Koontz, on the 7th of [fol. 3700] April the board of directors of Fidelity passed a resolution and sent you a copy of it?

A. That is true. That is true.

Q. And pursuant to that resolution you did represent Fidelity in the state court?

A. That is right.

Q. And at the time the petition was presented you appeared there for Fidelity, the Attorney General's office appeared for Sims, and you entered a consent order?

A. That is right.

Q. With your full approval?

A. That is right.

Q. As attorney for Fidelity? Is that right?

A. They accepted service, Mr. Townsend. I wasn't present. There was no answer filed for Fidelity, remember.

Q. You assented to the order that was entered?

A. Made no protest to the order.

Q. You assented to it, didn't you?

A. Have it that way if you will, sir.

Q. The order so recites, doesn't it?

A. I don't remember the order, sir.

[fol. 3701] Q. At the time the bill was presented to the Circuit Court of Kanawha County, was there a representative of the Attorney General's office there at all?

A. Yes, sir, Mr. Partlow was there.

Q. And the order that was entered with your approval, to which you consented, appointed Mr. Ross B. Thomas as one of the receivers? That is correct?

A. That is true.

Q. And he is a member of your law firm?

A. Associate of my——

Q. And the other receiver was Mr. H. Isaiah Smith?

A. That is true.

Mr. Palmer: Mr. Townsend, was it an order or decree entered?

Mr. T. C. Townsend: Well, call it either one, I guess.

Mr. Palmer: Well, I just wondered. It was either one or the other.

Mr. T. C. Townsend: There was one order—I don't remember—appointing these receivers. I don't think there was but one entered at that time. That is the only one I am inquiring about.

[fol. 3702] Q. Now, Mr. Koontz, Section 146 of Chapter 10 of the Bankruptcy Act provides in effect this: "A petition shall be deemed not to be filed in good faith under paragraph 4 when a prior proceeding is pending in any court and it appears that the interests of creditors or stockholders would be best subserved in such prior proceeding." Now, at the time the petition was filed in his Honor's court and since that time and now, is it your reasoned opinion and judgment that the best interests of the creditors and stockholders could be subserved in the Circuit Court of Kanawha County rather than in a district court of the United States?

A. With due respect to this Court, it certainly is, Mr. Townsend.

Q. You maintain that opinion now?

A. I do for a fact, yes, sir.

The Court: Do you mean in this particular proceeding, Mr. Townsend, or in any proceeding?

Mr. T. C. Townsend: My question was broad enough to cover any proceedings, I think.

The Witness: I didn't so understand it. I understood it to be confined to this case, of course.

[fol. 3703] The Court:

Q. Do you mean in this present proceeding, with Mr. Thomas as one of the receivers?

Mr. T. C. Townsend: That is what I mean, yes, sir.
The Witness: He said "the petition".

Mr. T. C. Townsend:

Q. Now, Mr. Koontz, I want to ask you this question. Assuming there exists a possible or a probable liability on the part of the management of Fidelity to the contract holders because of bad management, and it was deemed necessary to institute suits to recover wasted funds, do you think that could best be done in a state or a federal court?

The Witness: Shall I answer that, your Honor?
The Court: If that question is amplified as to whether he thinks it can best be done as a part or as a result of a proceeding in a state or federal court—your question, as you asked him there, does not mean that, as I construe it.
Mr. T. C. Townsend: Well, I will amend it as your Honor suggests. Now answer it as amended.

A. It seems to me if the liability were established on the part of anybody you could sue them either from a state court proceeding or a federal court proceeding. In other [fol. 3704] words, that the receivers could sue them or the trustee could sue them.

Q. Well, in this particular proceedings where do you think you would get the best results?

A. I am not sure that there would be any difference. I think that your state receivers——

Q. Do you think the chances would be equal?

A. They certainly would within the State of West Virginia, and if you would get on the outside of the State of West Virginia your receivers could bring suits in another state against anybody who was guilty of mismanagement.

Q. Well, it is your opinion, then, that you could get as good results in the Circuit Court of Kanawha County as you could get in the District Court of the United States for the Southern District of West Virginia against any officer of the company who might be guilty of or connected with the wasting of funds of the debtor?

Mr. Palmer: If your Honor please, I will have to object to that. Mr. Koontz has said whether a suit was brought in the Circuit Court of Kanawha County or the District Court of the United States for the Southern District of [fol. 3705] West Virginia is a matter of no importance. I

think what your Honor has indicated as a result of the proceedings in any of those courts may be pertinent.

The Court: That is right: It doesn't make any difference to this Court, if the liability were attempted to be established, whether a suit was brought to enforce that liability in federal court or state court. That is not the point. And I don't think that is what counsel intends to address the question towards.

Mr. T. C. Townsend: Well, that is. Is that question objectionable?

The Court: Well, if you mean whether the company or the receivers of the trustee could better succeed in a suit brought in a state court or in a federal court against someone who is alleged to have been guilty of mismanagement, then I sustain the objection.

Mr. T. C. Townsend: Read the question.

(The question was read.)

Q. Let's put it this way. Is it your opinion that you could get as good results if you proceeded against an officer of the company or if it was found advisable to proceed against an officer of the company for wasting the debtor's funds, [fol. 3706] in the Circuit Court of Kanawha County or in the federal courts.

Mr. Palmer: Objection.
The Court: Sustained.

Mr. T. C. Townsend:

Q. Let me ask you this question. In the state courts or in the Circuit Court of Kanawha County, your firm represents Fidelity. Would you—and I mean you—feel free and unhampered in any attempt that might be made to recover funds due Fidelity from any party whom it was deemed advisable to proceed against in the Circuit Court of Kanawha County?

A. Mr. Townsend, you stated in the beginning that we are counsel for Fidelity. May I ask that you correct that and tell me whether or not the record shows that we are still counsel for Fidelity, because, if I understood, Mr. Fleming was appointed counsel for the company later on, and I just assumed that that meant we were cancelled out as counsel for Fidelity.

Mr. T. C. Townsend: There is nothing in the record so far as I know, that cancels your attorneyship.

Mr. Palmer: No, I think Mr. Townsend is right, your Honor; there is nothing showing any right of Mr. Fleming [fol. 3707] or Mr. Ray to appear in these proceedings on behalf of Fidelity, and we have raised that objection before, that they have no right to appear as counsel here without the authority of the corporation, and we renew that objection.

The Court: Overruled.

Mr. T. C. Townsend: Will you answer that question?

A. I will answer that question and say that if there were any particular reason why we couldn't represent these receivers as against anybody because of close association or whatnot, we certainly would step aside and the attorney general would appoint somebody else to prosecute the case.

Mr. T. C. Townsend: Will you read the question, please?

(The question was read.)

Q. Can you answer that question yes or no and then make such explanation as you care to make?

Mr. Palmer: I object to that, your Honor. I think the witness has answered the question with a proper explanatory answer.

Mr. T. C. Townsend: I think his answer is equivocal. [fol. 3708] The Court: No, it struck me that he answered the question. The question, however, is objectionable, although no objection was made to it, in that it wouldn't make any difference whether they were proceeded against in the Circuit Court of Kanawha County or in the Circuit Court of California.

Mr. T. C. Townsend: That is right, your Honor, but I only used that because that is the only suit that is pending.

The Court: Well, you are confusing the suit that is pending with suits that may be brought to enforce the same liability. It doesn't make any difference, as far — I see, where the suit is to enforce the claimed liability for fraud; the question is whether the proceeding in the circuit court or the proceeding in the federal court is a more available and suitable way of arriving at a point where such suits can be brought, not as to whether those suits are proper one place or another.

Mr. Townsend: I think that is right. It is a question of which courts could furnish the best relief.

The Court: Yes, but don't confuse the courts in which these proceedings are pending with the courts in which some [fol. 3709] suit may be brought against some person that is alleged to owe money.

Mr. Palmer: If your Honor please, I would like to note another objection to that. It is not a question of the Circuit Court of Kanawha County. If Fidelity brings an action to recover it would have to be brought by the Attorney General as attorney for the plaintiff, Edgar B. Sims, who filed that suit, or the action, if need be, be brought by his agents, the West Virginia State Court Receivers. I think the distinction should be made in the question that if it is for the purpose of collecting the assets of Fidelity, then under the statutes of West Virginia that suit would be instituted by the State Auditor, who is represented, as the record shows, by the Attorney General in this suit. However, if it should be a matter of getting something that was outside the State of West Virginia, there would have to be some other persons appointed to handle that suit and it couldn't be that an action could be brought by the West Virginia State Court Receivers outside the State of West Virginia, because of the territorial limits of the West Virginia court.

[fol. 3710] The Court: Well, that particular distinction is largely technical, because if the state line were all that prevented the receivers from bringing the suit, the receivers would certainly have to do some act to associate some ancillary receiver or to instigate a proceeding at the hands of some ancillary receiver.

Mr. Palmer: I agree with your Honor, but the point I was making was that there is a distinction between whether it was an asset of Fidelity that the Auditor should collect and the Attorney General should bring the suit, or whether it is something that the receivers should take into their possession, as to whether or not Mr. Koontz's firm or the Attorney General should instigate such a suit, and the question does not make that distinction.

The Court: I think that is close enough, in view of the facts that have been brought out as to the character of this proceeding and the close association between the Auditor's office and the receivers, and particularly the firm of Mr. Koontz.

Mr. T. C. Townsend: Now, Mr. Koontz, will you answer the question yes or no and make such explanation as you [fol. 3711] care to make.

A. I would say yes, that I would have no hesitancy in advising what the rights are in connection with this receivership any more than a representative of the trustee would have a connection with the trusteeship, and if because of some personal relationship we couldn't go ahead and prosecute the suit fully, we would step aside and the Attorney General would certainly choose somebody to go ahead and prosecute the suit, and I don't say—mention that limitation—talk about personal association—I don't think of any personal association that would retard any affirmative action on our part.

Q. Or any business association?

A. Yes, personal or business.

Q. Or any association otherwise?

A. Yes, that is true.

Mr. T. C. Townsend: Your Honor, I would like to introduce the minutes—oh, they have already been introduced; Exhibit 97. That is the minutes of April 7.

The Court: You say they have been introduced?

Mr. T. C. Townsend: It is so marked here.

The Court: Then all you have to do is to refer to them.

[fol. 3712] Mr. T. C. Townsend: I had not noticed that. I don't care to ask any questions about it. Yes, I will ask this question.

Q. That is one of the original letters you spoke to me about?

(No answer.)

Q. You received that letter?

A. Yes, sir.

Q. Is that the first notice you had of your appointment as attorney to represent Fidelity?

A. It was, yes, sir.

The Court: I think you ought to let the record show what you are talking about.

Mr. T. C. Townsend: I am talking about the resolution that is contained in this letter—the resolution of April 7, 1941, that purports to be contained in that letter.

Mr. Palmer: What is the date of the letter please?

The Court: You ought to identify the letter on the record so we will know what letter you are talking about.

[fol. 3713] Mr. T. C. Townsend: Have you got a copy of it?

A. No, I don't have. That is read in the record, however.

Mr. T. C. Townsend: This letter has been read into the record.

The Court: But your question doesn't show that that is the letter you are talking about.

Mr. T. C. Townsend: I am aware of that. We will put it this way. On yesterday there was read into the record a letter dated April 10, 1941 addressed to the firm of Koontz & Koontz, Union Building, Charleston, West Virginia, and signed by F. J. McNulty, Vice-President and Secretary of Fidelity Assurance Association. That letter purports to contain a resolution passed by the board of directors of Fidelity with reference to employing your firm to represent Fidelity in the state court proceedings. My question was, is that the first notice you had of your employment?

A. It was, sir. With this verification from somebody—we were in touch with Wheeling quite often. Someone may have told us by phone that there had been such a resolution passed. But we received no notice after the [fol. 3714] passing of this resolution.

Q. You had talked about the state court proceedings to the board of directors prior to the resolution?

A. I talked to Mr. Foulk and Mr. Marshall, and, as I say, probably to Mr. Risley, and there may have been some other individuals. Mr. Townsend, remember, I had not been a member of the board for over a year, and I wasn't attending board meetings.

Q. Mr. Messick made the statement at that board meeting that on April 4, 1941 he had been informed that there was imminent danger of legal proceedings being instituted by the Auditor and Ex-officio Insurance Commissioner of the State of West Virginia, and that this meeting was called to inform the directors. Did you talk with Mr. Messick about it?

A. Oh, yes, a number of times.

Q. Did you talk to him on April 4th?

A. On April 4th or 5th Mr. Messick was in Washington, and I met him there and talked to him at some length.

Q. Then you told Mr. Messick when you talked to him at that time all about the understanding between yourself and the Auditor in reference to the institution of this pro-
[fol. 3715] ceeding in the state courts?

A. I told Mr. Messick what my advice had been, yes, sir.

Q. All right.

A. Yes, sir. I discussed it with him and discussed the various angles from a state court point of view and a federal court point of view.

Q. Mr. Koontz, did you attend the meeting of the board of directors in Pittsburgh on June 3, 1941?

A. Did I attend?

Q. Yes.

A. No, sir, I did not.

Q. Were you notified that they were holding a meeting?

A. I was notified that they were to hold one, yes.

Q. You were not a member of the board of directors at that time?

A. That is true.

Q. Did you attend the stockholders' meeting held in Wheeling last week?

A. No, sir, I did not.

Q. Were you notified of that meeting?

[fol. 3716] A. I heard about it. I am not sure a notice came. I don't believe I saw a notice, but that doesn't mean that one didn't come. I heard about the meeting to be held up there. Mr. Townsend, I am still a one share stockholder. I just assume the notice was mailed to all the stockholders. So far as I know I am a one share stockholder.

Q. That is all you ever held.

A. That is right. (Laughing.)

Mr. T. C. Townsend: That is all.

The Witness: Relative to some meetings in Washington which were talked about before, I desire to make the following statement relative to dates. The main and larger meeting was held March 17th in the office of Mr. Chester Lane. At the conclusion of that meeting it was decided that a smaller committee should work on plans briefly dis-

cussed at that meeting, and that there should be another meeting a little later on. The meeting set for later on was delayed, and the principals again met in Washington on the last day of March and the first day of April for further discussion.

[fols. 3717-3727] Cross-examination.

By Mr. Huwe:

Q. Mr. Koontz, as I understand it you favored a reorganization in the form of an insurance company—at least, that was your attitude prior to and during the state court receivership? Is that correct?

A. State the question again, please.

(The question was read.)

A. I felt that that was the only practical way to reorganize this company, in the insurance field or in some other field rather than in the face certificate field.

Q. Have you familiarized yourself, as attorney for Fidelity, with the insurance laws of the various states with respect to either administrative rules or provisions of law requiring a two year operation in the domestic state before being given permission to operate in the foreign state?

A. I know some states have that requirement. I think same have one year and some two years; I am not familiar with all of them.

. . . . . .

[fol. 3728] Q. Mr. Koontz, in the proposed SEC report of 1939, that is, the debtor's report prepared by your law firm, I think Mr. Ross Thomas performed the major part of that operation, did he not?

Mr. Palmer: I suggest that Mr. Huwe call it registration statement instead of debtor's report.

The Court: That would indentify it better, because that is what it has been called heretofore.

Mr. Huwe: Well, I stand corrected—call it the registration statement with the SEC. That was proposed and completed in 1939? Is that correct?

A. That is correct.

Q. What method of evaluation was used in that statement? Market?

A. Doesn't that speak for itself?

Q. Or West Virginia sound—do you know?

A. Well, I did know, but I forget.

[fol. 3729] Q. Is that in evidence, that registration——

Mr. Palmer: I don't think so.

Mr. Huwe:

Q. You wouldn't state from your own knowledge——

A. Market was in there, but I think some other methods were used too.

Q. You are sure you used market?

A. I feel sure——

Mr. Huwe: Mr. Thomas will verify that.

Mr. Thomas: The matter of valuation was a part of the accounting work on the report, which was prepared by Haskins & Sells. As I recall, the valuation was given both as to market, book and sound value.

Mr. Huwe: Thank you.

Q. Who drew the amended charter—your law office took care of that, did they not, the 1941 amended charter?

A. We took care of filing it.

Q. Changing it from an insurance——

A. Yes. We took care of filing it. As I recall, that was drawn by someone else.

Q. Oh, it was?

A. Yes.

[fol. 3730] Mr. Huwe: That is all.

Cross-examination.

By Mr. Ray:

Q. Mr. Koontz, you have testified that during the years 1938, 1939 and 1940 you were in touch with some twelve or fifteen financial houses for the purpose of securing money with which to rehabilitate Fidelity. Is that true?

A. That is true.

Q. At the time you were engaged in these negotiations, were you of the opinion that Fidelity was a company which should be rehabilitated and which could be rehabilitated?

A. I was.

Q. I would gather from what you have testified here that during your conversations with Mr. Marshall, with Mr.

Messick, Mr. Fleming, Mr. Sims immediately prior to the institution of the state court proceedings, that you were still of the opinion that Fidelity was an organization which should be rehabilitated and reorganized and could be rehabilitated and reorganized. Is that true?

A. That is true. Explaining, however, that we had been converted into an insurance company, and it was a ques-
[fol. 3731] tion of going ahead in that field and carrying on the business that you already had on the books and putting more business of like kind on the books if it were profitable.

Q. Well, it was your opinion that there was a place in the economic life of this country for a business such as this? Were you not of that opinion?

A. I was more of that opinion a few months ago, Mr. Ray, than I am right at the present time.

Q. That is what I am asking you, about a few months ago.

A. That is true.

Q. My question referred to a time prior to the institution of the state court proceedings. That was your opinion then?

A. That this business on the books could be carried on profitably if we could get this coupon cut down. That was always our plan—scheme of things.

Q. And you thought it was a business which should be carried on?

A. The business on the books, yes, sir.

Q. I mean, you thought that this principle of selling thrift
[fol. 3732] was a business which was for the public interest of the people of the country as a whole, did you not?

A. I always liked it very much if you could get it on a sound basis where you could earn what you promised to earn.

Q. And if it was properly managed and performed what it held itself out to perform, it was a good thing for the people as a whole, was it not?

A. I always felt that any thrift plan was a good thing if you put it on the right basis.

Q. And during your discussions with Mr. John Marshall, Sr., those discussions were solely with the view to reorganizing and rehabilitating this company, were they not?

A. That is true, yes, sir.

Q. And when the bill of complaint was filed in the state court, one of the prayers contained in that bill was "that all proper orders and decrees may be entered for the purpose of rehabilitating and reorganizing the defendant Fidelity Assurance Association"? Is that not true?

A. I assume it is. You are reading from it.

[fol. 3733] Q. You were familiar with the bill?

A. Yes, generally, yes, sir.

Q. Do you want to examine the bill?

A. No, not at all. I will say yes to the question, if it is all right.

Q. I would prefer that you do examine it here. (Handing witness paper.) Now, will you state on the record whether that is one of the prayers of the bill?

A. It is.

Q. I understood you to testify that prior to the institution of the state court proceeding you were unable to obtain any expressions of opinion from the Securities and Exchange Commission or from any member of the Commission or from any responsible department head of the Commission as to the court in which the reorganization of Fidelity should be attempted. Is that correct?

A. I think so. I never talked to any member of the Commission at all.

Q. Well, I say that was your testimony——

A. I think so.

Q. (Continuing.) And the only advice you could get over at the Commission from anybody was that that was a ques-

[fol. 3734] tion which the party which instituted the suit would have to decide.

A. That is right.

Q. Is that your testimony?

A. "You gentlemen will have to choose your forum."

Q. Mr. Koontz, it is in evidence here that Commissioner Healy, of the Securities and Exchange Commission, wrote a letter to Mr. John Marshall, Sr., in May 1941, and that Mr. John Marshall sent you a copy of that letter, and in that letter, which has been read into evidence here, is a statement to the effect that you were advised several weeks prior to the writing of the letter that it was the feeling of Mr. Healy, and not the official action of the Commission, but of those connected with the Commission, that the reorganization of Fidelity should be undertaken under the provisions of Chapter 10 of the Bankruptcy Act.

Mr. Palmer: If your Honor please, I do not want to object to that question, but I think Mr. Ray has quoted as nearly as anyone could from memory the portions of the letter to which he refers, but I think that perhaps the exact parts of Mr. Healy's statement should be used rather [fol. 3735] than an attempt on the part of any counsel to try to remember what that was, because there has been some discussion heretofore as to the exact content and meaning of those particular phrases.

The Court: I see Mr. Koontz looking for the letter.

The Witness: I am not sure that I have it. I have not seen that letter for some time. I don't know Mr. Healy; I don't know that I have ever met him. I never talked to him about this matter. That could still state the absolute views, for this reason, that, as I said yesterday, after this proceeding was filed and for some time thereafter I saw a number of times Mr. Schencker in Washington, who was head of a particular division of SEC, and he did say that his idea was that we would get better results under Chapter 10, but that was after our state proceeding was filed.

Mr. Ray: I did not get to complete my question, Mr. Koontz.

A. Beg your pardon.

Q. I was going to ask you, did you receive a copy of the letter which Mr. Healy wrote to Mr. Marshall?

A. I did.

[fol. 3736] Q. When you received the letter, did you write Mr. Marshall and notify him that the statements contained in the letter about the information given to you with respect to the opinion of the Securities and Exchange Commission was incorrect?

A. I am not sure that I wrote him.

Q. Well, would you examine your file and tell us whether you have a letter to Mr. Marshall in which you advise Mr. Marshall that the statements made by Commissioner Healy are not correct?

A. I shall, but I don't remember any such letter, and I think if I were disputing a member of the Commission of the SEC I would certainly remember it. I did talk to Mr. Marshall a number of times, however, and did tell him exactly what Mr. Schencker had said. I told him also about the former discussions with which he was already familiar.

Mr. Ray: I would much prefer to ask the witness the exact language contained in the letter, but it has not been introduced in evidence. Certain portions were read into evidence, which it may take a long time to find. If counsel thinks I have materially misquoted it——

[fol. 3737] The Court: The question is fair enough to be propounded, I believe. It is not necessary to have the exact words.

Mr. Ray:

Q. Mr. Koontz, what authority is there in the statutes of West Virginia or under the chancery practice of West Virginia for the reorganization of a corporation in a state court proceeding?

A. We have no reorganization statute in West Virginia, of course, as you know, but under your general equity powers of the state court you can reorganize.

Q. Then when you recommended that this proceeding be brought into the state courts, you knew that the receivers of that court would not have any authority or control over the assets of the corporation which were situate without the boundaries of West Virginia, did you not?

A. That is right.

Q. And you knew that the total of those assets was approximately ten million dollars?

A. Yes.

Q. You knew when you recommended this state court proceeding that there could be no reorganization of Fidelity [fol. 3738] in that proceeding unless every holder of common stock, every holder of preferred stock, every holder of a contract and every creditor, both secured and unsecured, would agree thereto, did you not?

Mr. Palmer: Objection.

The Court: In my opinion that is not a fair question. It should contain something further, that is, the qualification that those who did not agree to it be paid off their full equities, with the consent of those who did agree.

Mr. Palmer: That is right. That is what I had in mind.

A. You would have a hundred per cent reorganization in the event you could carry out the suggestion made in your question, Mr. Ray, where you could have a reorganization that could be very effective without the consent of all the people you mention.

Mr. Ray:

Q. Will you explain how, in a state court proceeding, you could have a reorganization of a corporation without the consent of all the stockholders and all the creditors?

Mr. Palmer: If your Honor please, if the stockholders [fols. 3739-3742] are shown, as in this case, to have no equity, you need no consent from them, if they have nothing left in the corporation.

Mr. Ray: If you want to take the stand to answer the question I will be perfectly willing to call you in a few minutes.

Mr. Palmer: I will be glad to do that, Mr. Ray, but I was making an objection to the Court.

The Court: Mr. Palmer is just objecting to the questions, and I think the question fails to take into consideration the fact that the Court mentioned a little while ago that there may be a reorganization without the consent of everyone, if those who do consent are willing that the ones who don't consent be paid off.

Mr. Ray: I expected that was the answer the witness would give to the question. I asked him how it could be effected, and I presumed that is the only way it could be effected.

The Court: That is a legal conclusion.

. . . . . .

[fol. 3743] The Court: Let's let Mr. Koontz explain that and get away from it. We are taking too much time. Go ahead, Mr. Koontz.

A. In 1940, after Rosset and Messick came in and became active and were having work assigned elsewhere, it was a question of settling with our firm, and discussion was had before the executive committee. As I remember, it was the executive committee, either the exeutive committee or directors' meeting in Wheeling; and a committee was appointed to check over and report back what fee they thought the firm of Koontz & Koontz was entitled to. On that com-[fol. 3744] mittee were Mr. John Marshall, Mr. Tom Foulk, and I am not sure but what another member or two; however, those were the active people. At our next meeting they did report back that they thought a fair fee would be a certain amount, as I remember that was $20,000, to finish paying the fee for all the work done. That was reported back to the next meeting and was accepted and ap-

proved, and some time after that was paid, but that is the way the final settlement on the larger payments was handled. That was the first half, I would say along about May or June, of 1940.

Mr. Ray: Q. You don't know whether that was ever adopted——

A. It was adopted——

Q. At a formal meeting of the executive committee——

A. It was adopted. It was; a committee was authorized in one formal meeting and the report made back to another formal meeting and passed.

Q. Well, the minutes don't show it, that I have been able to find.

A. I think that you will find that in an executive minute, and then that minute adopted later by your board of directors.

[fol. 3745] Q. After you leave the stand——

A. I will try.

(Q. (continuing): Find out if you can, and if you find it I would like to have it introduced in evidence. Mr. Koontz, before I took part in these proceedings, in reading through the transcript, I have seen that there were some references to the fees received by your firm during the years 1938, 1939 and 1940, and since I have been here the matter has been discussed on one or two occasions, and I would like to know whether Mr. Palmer reported to you what has taken place here at the hearing in that respect?

A. Generally that there was a report made in here showing the fees of our firm, and that those fees had been discussed from time to time.

Q. You had knowledge that the fees had been discussed here?

A. That is true. That is true.

Q. Do you not keep records in your firm showing each day what member works on a matter and how much time he spends on it?

A. We do. My secretary keeps my own record, and the [fol. 3746] bookkeeper keeps a general record.

Q. It is kept for every member and every associate of your firm, is it not?

A. That is true.

Q. Mr. Koontz, you were present in Washington at the meeting at which these plans prepared by Mr. Latta were

discussed with the Securities and Exchange Commission were you not?

A. Yes, I was.

Q. Mr. Palmer produced two of these plans here a day or two ago in this hearing, and when asked where they came from he refused to answer. Did they come from your files?

A. Frankly, I don't know.

Q. You had copies of those plans in your files did you not?

A. You say "those plans". I have had copies of many plans—several plans of discussions and digests and what-not, from Latta, from Messick and from Risley.

Mr. Palmer: They came from associates of the firm of Koontz & Koontz and from their files. Mr. Ross Thomas and Mr. Goldsmith gave them to me to look at.

[fols. 3747-3748] Mr. Ray: The exhibits to which I refer are Exhibits Nos. 111, 112 and 113, are they not, Mr. Palmer?

Mr. Palmer: Yes.

. . . . . .

[fol. 3749] Q. Mr. Koontz, when you first went with the company as a director in 1932, there is no doubt about it that Fidelity was in some financial distress? Isn't that correct?

A. That is correct.

Q. And you, not having any financial interest in the company, and being put on the board of directors presumably because of your experience and your ability as an attorney, used both your experience in financial matters together with your abilities as an attorney to aid in correcting that situation? Is that true?

A. I did.

Q. During the years from 1933 on, after Mr. Sims became State Auditor, did you from time to time have conferences with Mr. Sims?

A. I did.

Q. Did he more or less come to you as intermediary be-

[fol. 3750] tween himself and the company?

A. Quite often he did, that is true.

Q. And did he discuss the various problems which he, as state auditor, felt that he had in relation to the company?

A. He did. I don't know whether that would be exclusive, but he did discuss the company's problems many times.

Q. As one of the problems, did he discuss with you the

fact that in his opinion the salaries of the officers were too high, and ask you to bring that to the company's attention and take corrective steps?

A. Yes, he discussed that with me, and also that the officers—Senator Sutherland came down here and was present at Mr. Sims' office. He didn't confine that discussion to me, but various officers that represented the company.

Q. And did Mr. Sims, in his conferences with you, protest the amount or highness of the officers' salaries?

A. Oh, yes, he did, and there was a schedule of salaries agreed on at the time Mr. Sutherland was president.

[fol. 3751] Q. Did you convey that information to the company, that Mr. Sims demanded that salaries be decreased?

A. I don't remember that that was done with me personally. If it was, I conveyed it; but I think Senator Sutherland understood that direct and action was taken in accordance with a schedule that was set up.

Q. With reference to the National Sales company——

A. May I go a little further? Mr. Sims appeared before the board of directors a time or two and discussed these various matters you are talking about.

Q. With reference to the National Sales company, did you have knowledge that Mr. Sims appeared before the board of directors or before the officials of the company and ordered them either to close up the National Sales company or he would close Fidelity?

A. I have knowledge of his appearing before the board of directors one or more times, once in Washington, as I remember it, and I think probably once in Wheeling; and he never liked the side company handling the business of sales of Fidelity. I don't know just what statement he made about closing up the whole company if they didn't do it immediately or what that was, but his idea was that should [fol. 3752] be eliminated.

Q. In substance, National Sales company, in their contract, were to receive certain commissions for the selling of Fidelity bonds. Isn't that true?

A. It is.

Q. And in actual practice the company advanced them further moneys with which to expand their selling facilities. Isn't that true?

A. It is.

Q. After National Sales company was out of existence, or no longer played a part in Fidelity, isn't it true that the

selling force which Fidelity itself gathered together not only received its commissions, but the company had certain expenses in connection with selling their contracts, advertising and so forth, which could be compared with advances made to National Sales for the same purposes?

A. Well, we had the expense no matter whether we sold through an agency outside or sold direct, of course.

Q. In other words, after Fidelity started selling direct, after Mr. Carroll Evans had a very handsome salary as head of the entire sales organization, they had Mr. Reed, Mr. Pulfer and various other ones who were partly on [fol. 3753] salaries and partly on commissions to handle the sales ends, you had selling literature prepared, you had offices to procure and furniture to buy? Isn't that all correct?

Mr. Ray: Your Honor, I don't know what this is cross-examination of, but it has certainly already been introduced heretofore.

The Court: Overruled.

A. That is correct.

Mr. Palmer:

Q. So that the amounts the company advanced to National Sales were, in the opinion of the company, necessary for aiding in the selling of Fidelity contracts, if you know, isn't that true?

A. Well, I would assume so. Most of those advances were made before my connection with the company.

Q. Now, with reference to Mr. Messick, didn't Mr. Messick get the advice of Mr. Weaver, of Chicago, an attorney who specialized in insurance matters, with reference to the transformation of Fidelity into an insurance company?

A. Oh, yes. That is where he got most of his advice, I understood.

[fol. 3754] Q. And with reference to the question asked by Mr. Huwe about the various state laws, isn't it true that Mr. Weaver, after considerable study, prepared a legal brief for Mr. Messick in which his conclusions were that Fidelity for some years had been an insurance company, and that therefore it could qualify immediately in the various states.

Mr. Huwe: I object to that.

The Court: Overruled.

Mr. Huwe: I object specifically to the legal conclusion that Fidelity had been an insurance company for a number of years.

The Court: He is not asking for that legal conclusion. He is just asking whether or not Mr. Weaver prepared a brief in which he said that.

A. A report was prepared by Mr. Weaver, and then some very long letters in the nature of a brief were prepared by Mr. Weaver, in which he did take the position that Fidelity had been in the insurance business for some years and was really conducting an insurance business because of the fact that it insured its contract holders.

[fol. 3755] Mr. Palmer: And that for that reason it could comply with the state laws and requirements that an insurance company should have been in existence for so long—was that his conclusion and advice to Mr. Messick?

A. I don't know what he advised Mr. Messick particularly. I think that was his argument. We had already been in the insurance business for some time. I am not saying we took that.

Q. And it was on the basis of that opinion or series of opinions that he arrived at the conclusion that it was felt by the officers and attorneys that Fidelity could go ahead and attempt to rehabilitate itself as a going life insurance company?

Mr. Ray: If it please your Honor, we object to the admission into evidence of some opinion which has not been offered or any testimony about it.

The Court: Overruled.

A. Well, Mr. Weaver, who was brought in by Mr. Messick as an attorney, was the prime mover along the line of promoting the insurance business for Fidelity, and he was the one that was in conference with them in Chicago many times, came down here and was here for several days and [fols. 3756-3760] went to Wheeling and stayed for some time.

* * * * * * *

[fol. 3761] Q. How active was Mr. John Marshall in getting you to go with Fidelity and getting you to stay with Fidelity?

A. Well, he not only asked me; he rather insisted on my going, and, as I said in my testimony yesterday, I refused to go in the beginning, and they elected me a director without my knowledge or consent and just notified me of it in the beginning, and then from time to time we would talk about whether I should stay on any longer, and especially was that true after the company had apparently been rehabilitated and had gotten up to where they said they were making money in 1937. I talked to him about resigning from the board of directors and he insisted that I should not.

Q. Did you attempt or desire to resign from the board of directors after having been with a more or less sick company that had become well and on its feet——

A. I did, and talked it over with him and talked it over with Colonel Thompson. They insisted on my not resigning.

Q. You told them that you had finished your job and that the company was well—is that correct—or substan-
[fols. 3762-3767] tially that?

A. That is it.

Q. Did you have any correspondence with Mr. Marshall indicating his desire to have you either stay on with the company or come back to it after you had resigned from the board of directors?

A. Yes, more conversation than I have correspondence, however. He requested me many times to come back to the company and give it more time.

• • • • • • •

[fol. 3768] Q. Did Mr. Marshall talk to you about the retention of his son Jack as an employee of the state court receiver?

A. Mr. Palmer, I am not sure that he did. A number [fols. 3769-3772] of these people employed there did. I am not sure that—I am sure that Jack never mentioned it. I am not sure that his father mentioned it. His father seemed disappointed after Jack was let out that he had been let out, but I am not sure that he ever asked me to retain him.

• • • • • • •

[fol. 3773] Mr. Palmer: Now, Mr. Koontz, you have talked with a number of persons of more or less high financial repute throughout the United States, and you have been a director in a bank and still are a director and vice-president of a bank, and you were a director on the various committees of Fidelity for some years. Have you reached a conclusion as to what can or should be done with Fidelity in the future?

The Court: You mean an opinion?

Mr. Palmer: An opinion would be synonymous with conclusion, your Honor.

A. Well, I should like—am I permitted to answer?

The Court: Yes, he wants to know if you have reached an opinion.

Mr. Ray: Your Honor, I object to this question being asked on rebuttal. That is a question which certainly should have been asked on direct examination and give opposing counsel an opportunity to cross-examine this witness on that question.

The Court: You are right about that, but I am not going [fol. 3774] to confide this very strictly, and therefore if something new is brought out you will be given the opportunity to cross-examine.

A. Of course, I should like very much to see this reorganization. I am of the opinion, however—and if I may be permitted to use the same wording that you say Mr. Marshall used, it is based on discussions with people who know much more about financial matters than I—I am of the opinion that it canot be reorganized and operate in the field which it has been heretofore operating solely.

Q. That field being face amount certificates?

A. That is right.

Mr. Ray: Show an objection, your Honor.

The Court: Overruled.

A. A reorganization must be accompanied by marking down the rate of interest for reserves and a change generally in the business in the future.

Mr. Palmer: Have you formed or reached an opinion or conclusion as to whether or not Fidelity could succeed by being reorganized into a going life insurance company?

Mr. T. C. Townsend: Into a what?

[fol. 3775] Mr. Palmer: Going life insurance company.

Mr. Ray: Show an objection, your Honor.
The Court: Overruled.

A. Well, I would say under the present situation that that would be about the only chance of reorganization it would have.

. . . . . .

[fol. 3776] Mr. Palmer: "Charleston, West Virginia, the 11th, 11:35 A. M.

Honorable Allen G. Pflugradt, Chairman, Banking Commission of Wisconsin:

I have decided that my department should take over the affairs of Fidelity Assurance Association to administer same and work out sound rehabilitation and have filed suit in an appropriate state court asking for receivers and other relief. Reserve funds for contracts issued since 1932 seem solvent at market, and all funds as whole seem solvent at convention values or impairment is small, but association [fols. 3777-3779] is suffering overhead and other losses. My action will prevent impairment from becoming serious. Copy of bill being sent you by mail. I earnestly urge that you apply in your official capacity for ancillary receiver of assets in your states.

Edgar B. Sims, State Auditor, Insurance Commissioner."

And I think it already has been stated and agreed that that was sent out to some sixteen states. Am I correct in that, Mr .Townsend?

Mr. T. C. Townsend: Well, I assume it was sent to all the states where there were deposits, but I don't know whether there was any agreement about it or not. I am not objecting to it.

Mr. Lauritzen: Mr. Townsend, I wonder if it might not have been sent to all states where Fidelity had assets, whether deposits or otherwise, such as Texas, or anything of that sort.

Mr. Townsend: I don't know. You might ask Mr. Sims.

Mr. Lauritzen: Mr. Sims advises that he believes it was sent to twenty some states.

. . . . . .

[fol. 3780] Mr. Palmer:

Q. Mr. Koontz, what, if any, part in arriving at the decision of yourself and others, members of the board of directors of Fidelity to proceed in a state court did the fact that the company had for many years advertised the [fol. 3781] West Virginia law and advertised to the contract holders that they, if ever the need came, would be guided by their liquidation in that law—did that have on your decision, or did it play any part in your decision or preference between the federal and state court?

Mr. Townsend: The question was answered yesterday. That information was given by this witness in reply to questions I asked him.

The Court: I don't remember if it was. I overrule the objection.

A. It did. These statutes had been advertised in the selling campaign by putting the advertising in the literature from time to time and referred to, so I felt that as between the two, if everything else were equal, that you should follow your state statute because they had been used in your selling campaigns.

Mr. Palmer: Do you have any of the literature that was issued to the salesmen in that regard with you, Mr. Koontz?

A. Six booklets were put out some time ago as a sales course, and I have very little of the sales literature in [fol. 3782] my office, but I did have these books, this sales course, left over; and some references are made in book number five as to what the salesman should tell the prospect.

Mr. Palmer: I am going to ask the Court's permission to read one paragraph from page 28 of Book 5. I don't think it would be pertinent to introduce the entire book. The book is entitled, "How to Win the Final Decision," and shows a Fidelity subscription with two gentlemen shaking hands above it with a fountain pen, and it is entitled, "Training Course for Fidelity Career Men," and is copyrighted by Fidelity Investment Association.

Mr. Jaegerman: Before we have it read, could we have the approximate period when that book was used?

Mr. Palmer: It is copyrighted 1936.

Mr. Jaegerman: Does Mr. Koontz know?

The Witness: Sometime after that. I would say in 1937 was when it was used. It was when they were going pretty well. Copyrighted in '36—'37 and possibly '38—that is, sales training courses during those years. These came out periodically over several months.

Mr. Jaegerman: Would they be approved by the direc-
[fol. 3783] tors?

A. They had what is known as an advertising committee representing the directors. Somebody from Chicago, an advertising man, was head of that committee.

Q. Were you on that committee?

A. No, I was not.

Mr. Palmer: There was just a paragraph in the pamphlet which I deemed important. The first one is the first paragraph on page 28. "When the prospect has once again agreed to the second buying decision, you proceed by saying, 'In view of Fidelity's splendid record, together with the important legal safeguards which it provides, there can be no question in your mind as to Fidelity's absolute dependability and safety in fulfilling its share of the plan, can there?'"

Now, on page 55, next to the last paragraph, under the heading "Objections to Decision Three, the Institution Behind the Plan," the sub-heading "Is My Money Safe With Fidelity?" and the first paragraph in quotes begins, "Mr. Prospect", and the second paragraph, "Fidelity has always been guided by the soundest and most conservative principles of investment, safety, security and sound con-
[fols. 3784-3785] servatism have always been and always will"—the word "will" being emphasized—"be the first consideration in the investment policy of this institution. The loss of a single penny to any contract holder is a possibility quite remote, made doubly remote by the many rigid state laws and the departmental supervision under which Fidelity operates."

* * * * * * *

[fols. 3786-3788] Q. You didn't ever get any new capital in all your efforts?

A. That is right; that is right.

* * * * * * *

[fol. 3789] H. ISAIAH SMITH recalled, testified as follows:

Cross-exaination.

By Mr. Farmer:

Q. Mr. Smith, how many contract holders made payments to the trustee on contracts during the month of September, 1941? Have you that information by the various series of contracts?

A. Yes, I have.

Q. Will you give that, please?

A. I am advised by the office that the records show that the following payments were received on contracts for the month of September: Special Income contract account, 4 payments were made on contracts; special annuity contract account, 270 payments were made on 224 accounts; [fol. 3790] income reserve contract Series A account, 247 payments were made on 196 contracts; income reserve contract Series B account, 3,055 payments were made on 2,254 contracts; income reserve contract Series D account, 131 payments were made on 95 accounts, making a total of 3,707 payments on 2,773 accounts.

The Court: I would like to know, Mr. Smith, whether or not these contract holders have been advised by the trustee as to whether or not they should continue making payments and what, if any, effect that would have on their rights in this proceedings.

A. The contract holders have been advised by both the receivers—if I may include the receivers—and the trustee that none of their equities will be lost by failure to keep up the regular monthly payments.

Mr. Farmer: That advice that you spoke of, was that in one of these form letters—one or more of these form letters that has already been filed in the case?

A. I think those exhibits will contain that information.

Q. Do you remember which one?

[fol. 3791] (No answer.)

Q. Are you referring to the letter of July 3rd (handing witness paper).

A. No, a subsequent letter. I don't see it in this letter right off, but there has been a letter gone out from the trustees to the effect that no equities will be lost by rea-

son of the failure to keep the monthly payments up, and also we have answered, I would say, thousands of letters individually, when they would write in and ask specifically what would happen to their contract if they didn't keep the payments up. In all cases we have told them that their equities were fixed as of the date of the appointment of the trustee.

Q. I want to get just exactly what that advice was in these circular letters.

A. Here is the paragraph in the receivers' letter. "One effect of the receivership has been to fix your status as a creditor as of the date of the receivership."

Q. What letter is that you are referring to?

A. That is the receivership letter.

Q. That is in Exhibit 32 you are referring to?

A. Yes.

[fol. 3792] Q. Well now, the sentence that you referred to is this in that exhibit, is it not?

A. That is right.

Q. "One effect of the receivership has been to fix your status as a creditor as of the date of the receivership, both as to the amount of your claim and with respect to the particular assets held to satisfy the same." Is that the sentence you are referring to?

A. Yes.

Q. Have you got there any communication from the trustee telling them that they didn't have to pay?

A. It is not in this exhibit. There has been a statement sent out by the trustee which gives a running narrative of all these proceedings. I don't happen to have one with me, but I could get one from the office.

Q. Is that a circular letter?

A. It was sent out in answer to inquiries.

Q. A prepared form for use in answering inquiries?

A. That is right.

Mr. Farmer: I would like for you to get that. I thought that we had all the circular communications.

A. It was sent out—prepared about a month ago.

[fol. 3793] Q. Do you find here a notice from the Central Trust Company, trustee, to the owners of Fidelity Assurance Association Series B contracts dated August 22, 1941?

A. No, I don't see that.

Q. That was apparently in among those notices that were filed at the previous hearing?

A. If I recall, these were filed during the first hearing in August.

Q. That is right. Yes. I hand you a notice dated August 22, 1941, and will ask you if that was a form of notice that was sent out by the trustee about that time to all contract holders?

A. It was sent to the owners of Series B contracts that had insurance protection.

Q. And I will ask you to file that copy as Exhibit No. 117.

Exhibit 117

(The paper referred to was filed, marked as above indicated, and is attached hereto as a part hereof.)

Q. That letter tells them, doesn't it, that it will be necessary for the owners of Series B contracts, where Section [fol. 3794] 6 is effective (providing for insurance protection) to make full payments if they want to keep their insurance in force? That sentence is in that letter?

A. That is true. That is correct, if they want to keep their insurance in force, but failing to pay would not affect the equity in their contract as it existed at the date of the receivership or the appointment of the trustee. The only feature that would be dropped on the Series B contract would be the insurance protection only.

Q. And that also tells them that in order for contract holders who have taken advantage of the previous three month grace period to have the opportunity to bring their contract payments to date, this requirement will become effective on August 31, 1941, by which time all payments now due or past due, including the payment for interest, must be made?

A. That is right.

Q. You were asked on the stand about the notice of deficiency assessment by the Commissioner of Internal Revenue?

A. Yes, sir.

[fol. 3795] Q. (Continuing.) For income taxes. That assessment, you said, was for the taxable years 1935, 1936, 1937, 1938 and ten months of 1939?

A. That is right.

Q. And that was your income and excess profits taxes for those years?

A. That is right.

Q. You said that amount was approximately $260,000?

A. Approximately $265,000.

Q. Is this a copy of the notice of assessment dated May 20, 1941, to the receivers?

A. Yes, it appears to be.

Q. Will you file that as Exhibit No. 118?

Exhibit 118

(The paper referred to was admitted in evidence, marked as above indicated, and is attached hereto as a part hereof.)

Q. State whether or not there was a supplemental proof of claim filed with the receivers which brought the total claim for income and excess profit taxes for those years up to $289,616.56?

A. That is right.

[fol. 3796] Q. State whether or not notice was also given to the receivers, or rather whether proof of claim was filed with the receivers, for additional taxes, that is, social security taxes in the amount of $6,506.58?

A. That is right.

Q. Is the total claim for taxes filed by the federal government $296,123.14, including interest up to some date in May, 1941?

A. Yes, and there is—there was an overpayment for one of those years which will bring the net tax down to approximately $265,000.

Q. I will ask you to read this letter of May 27, 1941, and state whether or not you were in error in stating that that will bring it down.

The Court: Don't read it into the record.

Mr. Farmer: No, I am just refreshing him on it.

A. I am familiar with this. This increases it $30,130.14—increases this amount on the face of the claim—but subsequent to this—and I don't seem to find it in the files—we have already filed that, but we can't get the refund until we pay the tax—pay the Internal Revenue Department—[fol. 3797] but it has held that there is $30,000 refund due the association on some of the previous years, I don't recall which, making a net in the neighborhood of $265,000.

Q. Does this letter of May 27, 1941, to the receivers state that the total amount of the tax, with the notice attached, was $319,723.70, and then state that there was an over-assessment of $29,911.25, which would bring the amount claimed down to $289,616.56?

A. Yes, I am familiar with this, but I still state that there has been an overpayment which would bring the total down on the basis of this assessment to something in the neighborhood of $265,000 from that amount there.

Q. Have you got any supplemental notices that will substantiate that?

A. I don't seem to find them in the file, but the application was made, as I understand, by Haskins & Sells representing the trustee in the case. In order to protect the claim it had to be filed within a certain time, and that has already been done.

Q. Well, I believe I will have to ask you to file this copy of this letter of May 27, 1941.

[fol. 3798] The Court: I sustain an objection to that. I don't think it has anything to do with this.

Mr. Farmer: Well, I would like to ask for the letters or communications that will prove that, then.

The Witness: I can't find them in the files. I searched for them. I just recall from memory that there was a refund due the company and proper application was made.

Q. You mean in addition to this over-assessment of $29,911.25 that is mentioned in this letter?

A. Yes.

The Court: Mr. Farmer, if there were taxes of a million dollars claimed by the government, what bearing does that have on the case?

Mr. Farmer: If the Court please, the taxes, if they are liable for them, will be a preferred claim against the general assets of the estate, and I should say that a $300,000 preferred claim out of the general assets would point out the much greater difficulty of bringing about a reorganization.

The Court: I don't think that has any bearing on the issues involved, whether this company is 10 per cent insolvent [fols. 3799-3806] or 10½ per cent insolvent, in my opinion, can make no difference in the prospects of this reorganization.

Mr. Farmer:

Q. Mr. Smith, that additional assessment or deficiency assessment was due primarily to the government agent investigating and including all of the income from the various reserve funds with the income account of the general fund.

A. That is right.

The Court: Mr. Farmer, I have told you that I do not regard that as having any bearing on the case, and I am not going to permit the record to be stuffed with it.

Mr. Farmer: Well, I would not have asked it if I didn't think it was relevant and some Court might differ with your Honor on it.

The Court: I am not going to permit it to go on the record any further.

Mr. Farmer: I except to your Honor's ruling. I would like to go on with the evidence on it.

. . . . . .

[fols. 3807-3810] Mr. Eney: May I break in that point?

The Court: All right, Mr. Eney.

Mr. Eney: Your Honor held our motion should be heard at the close of the case, and I assume the purpose was that your Honor should consider all the evidence offered at this hearing in ruling on that motion. I want to have an understanding if that is the case.

The Court: That is correct.

Mr. Eney: All the evidence on this hearing is evidence on our motion?

The Court: Yes, that is correct.

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[fols. 1-4] Arlen G. Swiger, called as a witness by the Trustee, having been duly sworn, testified as follows:

Direct examination.

By Mr. T. C. Townsend:

Q. Your name is Arlen G. Swiger?

A. That is right.

Q. Where is your residence?

A. New York City.

Q. What is your profession or business?

A. I am an attorney.

Q. Did you at one time practice law in West Virginia?

A. Yes, sir, I tried to.

Q. A native of this state?

A. Yes, sir.

Q. Did you ever hold any public position in this state?

A. Well, a very small one.

Q. What was it?

[fol. 5] A. A member of the legislature.

Q. Mr. Swiger, how long have you lived in New York City?

A. Since 1919.

Q. I hand you herewith a letter signed by you, dated September 24, 1941, and addressed to the Central Trust Company. I will ask you to inspect the letter and state whether or not you wrote the letter and signed the letter.

A. Yes, sir, I did.

Q. I will ask you further to examine what purports to be a copy of that letter attached to the petition filed in connection with the subject matter of that letter and state whether or not that is a true copy of the original letter.

A. Yes, sir, that is a copy of the original letter of September 24, 1941.

Mr. Farmer: If the Court please, I hate to ask this question, because I ought to have heard what the Court said about it, but I didn't. Is this a part of the record in this, or not?

Mr. T. C. Townsend: I will clear that up if you will [fol. 6] just let him put this testimony in.

Mr. Farmer: I didn't understand what the Court's ruling was.

The Court: It is to be heard as an independent proceeding, and then such parts of it as are pertinent to the questions involved in the general hearing, as I understand, will be offered as a part of the record by Mr. Townsend.

Mr. Farmer: Well then, we will have the liberty to offer other parts? Is that right?

The Court: That is right.

Mr. Townsend:

Q. Does this letter to which you refer contain the proposition of Pell, Ltd., with reference to buying the capital

stock of Fidel, a wholly-owned subsidiary of Fidelity Assurance Association?

A. Yes, sir, that is an offer on the part of Pell, Ltd.

Q. Are you familiar with the financial affairs of Pell, Ltd.?

A. Yes, sir.

Q. Are you in position to tell the Court whether or not [fol. 7] Pell, Ltd., is in a financial position to carry out and comply with this offer if it should be accepted?

A. Yes, sir, I will say that if this offer is accepted and in our opinion good delivery can be made of the stock, we will be prepared to accept and pay for the stock at that time in cash.

Q. In accordance with the terms of this letter?

A. Yes, sir.

Mr. T. C. Townsend: Your Honor, for the benefit of, or in response to a request made by an attorney representing one of the defendants here, I think it might be well for me just to read this letter so they will know its contents. It is short.

The Court: All right. There is no use to put it in the record. It is a part of the petition, isn't it?

Mr. T. C. Townsend: Yes. I don't mean to read it into the record.

(Mr. Townsend thereupon read the letter referred to to Court and counsel.)

Mr. T. C. Townsend:

Q. Mr. Swiger, in this offer made by you you refer to Fidelity Assurance Association to the effect that you are [fol. 8] prepared to give serious consideration to furnishing additional capital in connection with Fidelity Assurance Association if you are successful in acquiring Fidel, or the capital stock of Fidel. I wish you would explain to the Court, if you will, in your own way, what you mean by that statement.

A. A part of the directors of Pell, Ltd., are fairly well acquainted with Fidelity Investment Association. At least three years ago they made an examination into the financial affairs of Fidelity for the purpose at that time of reorganizing or investing new capital or both. At that time, at our own expense, we had Haskins and Sells prepare a special report for us on Fidelity. We had many conferences with

the executives of the company, and the negotiations had, I would say, reached a serious stage. Those negotiations were interrupted by litigation in which Fidelity was involved, and we naturally didn't continue with our efforts to reorganize or to acquire an interest in the company.

Now as to Fidel, in our examination of the affairs of Fidelity we naturally looked into the Fidel company, be-
[fol. 9] cause it is a New York corporation. I think one of my associates organized Fidel, and I believe he drafted the indentures under which Fidel now operates, so we—that is, my own office and my associates as directors of Pell, Ltd.—were and are fairly well acquainted with Fidel.

As a result of this investigation, which has continued over a period of years, and of our recent investigation of the Fidel Company, we are making this offer for the Fidel stock. We are also interested in working on a plan of reorganization for Fidelity. Now, from our standpoint that is a difficult job. It involves a lot of considerations. We don't know what the situation will be in reference to Fidelity when this litigation ends. We don't know what the general business conditions in the country may be at the time that this litigation ends and the proper time comes for the filing of a plan of reorganization. However, we want to make this point clear: we don't want to base our purchase of the Fidel stock on a promise to finance and reorganize Fidelity. If we purchase the Fidelity stock, at our own expense——

[fol. 10] The Court: You mean Fidel.

A. Fidel. If we purchase the Fidel Stock, at our own expense we propose to make this study and examination of Fidelity and see if we can work out some feasible plan. We have in mind that it has value if it could be reorganized and operated in a manner which would meet with the approval of the Securities and Exchange Commission and various other government and state agencies which might look into it.

Mr. T. C. Townsend:

Q. Let me see if I understand just exactly what you mean by your answer. If you are successful in acquiring the capital stock of Fidel, then, as I understand you, it is your purpose to make an investigation of the affairs of Fidelity to the extent of determining whether or not you shall, in con-

nection with these proceedings and at a later date, file or suggest a plan of reorganization?

A. Our group is seriously interested in working out a plan of reorganization for Fidelity.

Q. And of course whatever you did in that connection you would do at your own expense.

A. Yes.

[fol. 11] The Court: Let me ask Mr. Swiger a question in order to fully understand what he means. Do I understand that the consideration which you will give, as you say in your letter there, to the refinancing of Fidelity—does that contemplate that your group would, at the proper time if you determine that you want to go ahead, put in the money for a capital structure of a new or reorganized company, and that that money would come through Fidel?

A. I will answer that question this way, if I may. I don't think that money would come through Fidel. I think it might be new money. I couldn't naturally, say what form our plan or reorganization would take, but it would certainly require some additional money, which we would be prepared to furnish as a part of that plan. I see no way now by which the funds of Fidel could be used for that purpose, and there would be no desire on our part to use Fidel money for that purpose.

Q. What I meant was, would it through Fidel, by making your investment in Fidel and then having Fidel to put up the capital structure contemplated.

[fol. 12] A. It is quite possible that the order of Fidel and Fidelity might be reversed, and it might be possible, from our study of the situation, to make Fidel the top company and Fidelity the subsidiary. That might be worked out.

Q. Whatever you have in mind involves the creation of a capital structure which would be actually invested by your group, and does not contemplate simply a promotion whereby you would take that matter of getting the capital together to the general public in a sales campaign of any kind, does it?

A. We are not interested in attempting to revive Fidelity as such and to continue along the same plan it has been operated in the past. It is our judgment that something radical has to be done, probably a new plan. Probably it must have something new to sell that is a little different from what it has been selling.

Q. What I was more interested in in connection with the capital that may be put into a reorganized company, I want to know whether it is the idea that that capital stock be got together by any sort of promotion work with the general [fol. 13] public, or is it the idea that that will be capital advanced by your group of investors?

A. I would say that any plan of reorganization which we would offer to the court which involved new capital will be capital raised by our group. We don't anticipate selling securities to the public.

The Court: All right. That is what I wanted to know.

Mr. T. C. Townsend:

Q. Just following up the question asked by His Honor, there is appended to this petition filed here a list of the directors of Pell, Ltd., quite a long list. Are you acquainted with these directors?

A. Yes, I know all of them.

Q. Do you know something about their financial responsibility?

A. Well, it is difficult these days, Tom, to know anything about people's financial responsibilities, but I will say this: they are all successful in their particular lines of business; they are considered men of good judgment and experience, men who meet their obligations.

[fol. 14] Q. Well, let's assume you became interested in Fidelity to the extent of venturing a plant of reorganization, and you could interest in Fidelity the same people who are listed as directors of Pell, Ltd., from that source do you feel that you could acquire the additional capital necessary to refinance Fidelity?

A. Well, we are of the opinion that it is easier to get the money than it is to get the management.

Q. Then you feel that you can get the money if you can get the management?

A. Yes, sir.

Q. And in your group do you feel that you could get both management and money?

A. Yes, if it holds a chance of reasonable compensation for those who invest their money in it. And I mean to qualify that by saying, there is no one in this group that is looking for salaries, nor are they looking for quick profits, but

they would hope to build this up so that eventually they would have something worthwhile.

Q. When you say "build this up", that answer relates [fol. 15] to both Fidel and Fidelity?

A. Yes, it does. I might also add that as far as Fidel is concerned, from our group we have designated three directors who would be the directors of Fidel if we were acquiring the stock. Those are Mr. Pell, Mr. Cecil Stewart and Mr. Rosenblatt. Those three would act as the officers and directors of Fidel without compensation.

Q. You stated that your group would not be looking for quick profits. Would you care to expand that a little and state over what period of years you would expect to act?

A. Well, of course, these plans are only tentative, and to this time there has been much discussion but nothing definite; but it is the idea of this group of men that is a situation out of which little or no profit should be taken for a period of probably eight or ten years.

Mr. T. C. Townsend: I think that is all I want to ask this witness.

The Court:

Q. Mr. Swiger, I would like to inquire this of you. Your group understands, does it not, that at present the question [fol. 16] of the jurisdiction of the federal court to entertain this reorganization petition is in question here, that there is a hearing going on to determine that question of jurisdiction, and that it may be some time before that is determined? What I want to ask you is this: if that question of jurisdiction is not determined by the time this offer runs out, is there any expectation of a renewal or extension of time in connection with the offer?

A. Well, I want to make this clear. I am not coming here on behalf of this group of men to wage any fight for the stock of Fidel. If there is serious opposition to it, we don't want it. We don't propose to be involved in any controversy whatever. I think there is a situation that should be given consideration. I understand that a number of contract holders of Fidel have turned in their contracts for cash. I think that amount is about $600,000 since the first of July. Now, that raises the question as to whether that is going to continue or whether it may slow up. If it continues the corporation will in effect be liqui-

dated by the contract holders, and there will not be much [fol. 17] left. If we acquired the stock we would hope to take some action to stop that, if we could. I will discuss with my clients the question raised by the Court about October 19th. I am inclined to think that if for some reason action is not taken on this matter at the time mentioned in the offer, that we will continue this offer, provided there is no radical change in Fidel. We don't want to precipitate this matter at all; we don't want to hurry anybody about it.

Q. Your offer itself contains the condition that you must be satisfied with the authority to deliver. I assume that you will not be satisfied of that until you know whether or not this Court has jurisdiction to authorize it?

A. There is a serious question in our minds just how we can get good title to the stock. We probably will have to engage most of counsel sitting around the court here to tell us the answer to that question.

The Court: All right. Does anyone wish to cross-examine Mr. Swiger?

Mr. T. C. Townsend: I am sure those counsel around the table can never agree on it.

[fol. 18] Cross-examination.

By Mr. Palmer:

Q. Mr. Swiger, for the purposes of this record, which may or may not become a part of the record of the other case, I would like to ask you some questions. Is Pell, Ltd., a corporation?

A. Yes, sir, a Delaware corporation.

Q. And would you mind stating into the record the type of business engaged in by Pell, Ltd?

A. Pell, Ltd. maintains an office at 60 East Forty-Second Street, New York, and its directors meet rather frequently for the purpose of discussing new and old business matters which may come to its attention. It might be a reorganization, it might be the sale of a utility in Central America, it might be a new process of making a chemical or some other matter which is of interest to this group of men.

Q. Do I understand by that that this group of men supply capital, money, to various enterprises?

A. Only to their own enterprises. If something is called to their attention and they think it is worthwhile financing

and managing, they provide the finances, sometimes within [fol. 19] their own group and sometimes they will invite someone from the outside to come in and furnish a part of the capital.

Q. May I ask the capital structure of Pell, Ltd., that is, financially?

A. I should know that, but I don't, but I can say this to you. Pell, Ltd., had fifty thousand dollars not long ago in its treasury. It pays no salaries. The only employee is a secretary, a young lady. Its only other expense is the rent for the office and stationery and telephone calls and so forth; and it was never intended that the money of Pell, Ltd., itself would be used for these various matters, but if this group of men, after much discussion and much talk pro and con, decided that it was to their interest to go into a proposition, then they themselves with their associates would furnish the capital.

Q. Do you do in any sense of the word a brokerage business?

A. In no sense a brokerage business.

Q. Do you sell issues of stock to the public?

A. No sale of securities at all.

[fol. 20] Q. Am I to understand that this is more or less a partnership, but however, in a corporate form, whereby the gentlemen who are engaged in it, if a project is interesting to them, will go into that project, individually or as a group, and do what they feel is necessary in connection therewith?

A. Well, it does in many respects have the form of a partnership, although it is a corporation. I think all the stock of the corporation is owned by the directors, and naturally we consider many propositions. Most of them are turned down; we consider them bad and we don't enter into the particular matters pending before us.

Q. Let me ask you this. Suppose the Court would approve this proposition. At the present time, from what you have told us, there would not be enough cash in Pell, Ltd., to pay for it? Is that correct?

A. Yes, sir. There never is enough cash in Pell, Ltd. to pay for the propositions that we may enter into.

Q. That was my understanding. However, if the board of directors determines to go into it, then they advance

[fol. 21] money into the treasury of Pell, Ltd., or what is the procedure?

A. Well, the procedure is rather a practical one. We know each other very well. We know where the money is coming from and in what amount; and probably if we worked out all the problems in connection with the purchase of this security, and I was advised that it was to be delivered in Charleston on Tuesday against cash, probably on Saturday or Monday I would call my associates on the phone and get the money and be here with the cash or a certified check.

Q. The point I am getting at is, however, that in the event the court should permit such a contract to be entered into by the trustee and Pell, Ltd. would later, after entering into the contract, for any reason whatsoever be unable or unwilling to carry it through, there would be no corporate libility to which the trustee could look for a breach of that contract.

Mr. Hillis Townsend: I don't know that there has been any proposal here to enter into a contract.

Mr. Palmer: Contract for sale of the stock.

Mr. Hillis Townsend: There isn't any——

[fol. 22] A. We don't expect to have the stock delivered to us until we pay for it.

Mr. Palmer: That was my understanding, but what I am trying to find out is this, sir, and I am only asking for the information of the record and the Court. Pell, Ltd. itself, as you have told us, has so much capital.

A. Yes, sir.

Q. The contract for the sale of the stock, or the acceptance of the offer made, would be made with Pell, Ltd., a corporation. If Pell, Ltd. were unable or unwilling to carry it through, the only liability to which the trustee could look would be the assets of Pell, Ltd.? Isn't that correct?

A. From a legal standpoint that is correct. However, you have coupled with that the integrity of a substantial group of men who I do not believe would negotiate on that basis with this Court.

Q. I understand that, and I am attempting to get the legal situation into the record here. Now, also, if Pell, Ltd. should buy this and there should be mismanagement—I am

[fol. 23] not suggesting that there would be, but if there should be, by Pell, Ltd.—the only ones to whom the contract holders could look would be to the corporate liability of Pell, Ltd., and not to the individuals? Isn't that true as a legal situation?

A: I would think not. I would think if Messrs. Pell, Stewart and Rosenblatt become directors and officers of Fidel, I think they would be personally responsible for mismanagement.

Q. But the owners of the stock would, of course, again be Pell, Ltd.—is that correct—or would the stock be distributed among the directors of Pell, Ltd. individually?

A. Although the details of that are not worked out, I would think that the stock would be distributed, part of it going to directors and part of it to Pell, Ltd.; maybe some to one or two associates.

Q. Would it be fair to say that Pell, Ltd. is a holding company, or in this company would act as a holding company of the stock of Fidel?

A. No, it would not. I would say the arrangement would be rather a simple one; probably five, eight or ten people would provide the money. Pell, Ltd. would acquire the [fols. 24-32] stock, and at a later date it would transfer part of the stock to those who had provided the cash.

Q. In furtherance of the Court's question, would any of that be offered to the public generally or to certain individuals of the public whom you term associates, or are they already predetermined?

A. If there is anything I want to be positive about it is that there is going to be no public offering in connection with our negotiations in reference to Fidel or Fidelity.

* * * * * * *

[fol. 33] Mr. Palmer: Your Honor, I am not too familiar with these proceedings myself, and I am asking Mr. Swiger to help me on it, but my understanding is this, that in each Series B. Contract it is provided that the profits made by or through the lapsation and cash surrenders—we have discovered that Fidelity makes the same kind of profits—are kept in that series fund, and half of the profit on that goes to those contract holders who mature their contracts and half of it goes to the company. Now, if all of the contract holders lapse and cash surrender their contracts

before maturity, then the company would get the whole of that profit.

The Court: You mean if they do that after these people take hold?

Mr. Palmer: Yes, that is what I am asking, and I think that can be done, although I don't know. As I say, Mr. [fol. 34] Swiger has studied this company and I have not, and I am saking his advice and opinion on that particular problem.

The Witness: Our minds have run along the other angle. We are somewhat disturbed because the contract holders are turning them back for liquidation, and we have not looked at it from the standpoint—your standpoint, Mr. Palmer.

The Court: You wouldn't expect, Mr. Palmer, that any prospective purchaser would be willing to pay some extra consideration on the possibility that there would be contracts lapsed or surrendered out of which they might derive a profit, would you?

Mr. Palmer: Yes, I would, Your Honor. That is just what the Court was asking one of the witnesses to consider yesterday, that experience had shown with these companies that that was what happened time after time and that was a legitimate source of profit to the company.

The Court: Yes, of profit, but not of present value.

Mr. Palmer: If that is the normal experience and it is [fol. 35] shown that that will be made and turned into a profit, all things being equal there should be some payment made for that.

The Witness: Well, I want to state for the purpose of the record that I think all interested parties should give serious consideration to our offer, and it may be possible that somebody will make a better offer. I will not be disturbed if they do; and I want all parties interested to feel that our offer is a fair and reasonable one and it is the best offer that you can obtain at this time, otherwise we would not want to buy this stock.

Mr. Palmer:

Q. Mr. Swiger, may I ask this? Is it your plan to issue new certificates and sell them, such as Fidel had issued in the past?

A. Mr. Palmer, that question will not be decided until we have purchased the stock and have our money invested,

and we will probably leave it alone as it is for a short period of time and make a very careful study of what we can do about it.

Q. Mr. Swiger, answer me this. Suppose that I am a contract holder of Fidel and I hear of this offer of yours. [fol. 36] Would you show me where I am going to be benefitted by your purchasing that stock?

A. Well, perhaps you might be pleased with the new management.

Q. Well, is that the only thing that you have to offer to the contract holders of Fidel, a new group of men to manage it for them?

A. I understand that their rights are pretty clearly defined in the contracts which they own and have bought and paid for, and I don't see anything we can do for them that would help their position more than to honestly, and I hope ably, administer the affairs of the corporation.

Q. You would have control of how many million dollars of funds for investment purposes?

A. I can't give you that figure. It is in the statement here. Whatever is there we would have control of.

(Mr. Palmer hands paper to witness.)

The Witness: I have to leave the hotel at 2:50. I can't miss that plane.

The Court: I think we ought to get through with him [fols. 37-41] then.

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[fol. 42] Joseph R. Kelley called as a witness by the Trustee, having been duly sworn, testified as follows:

Direct examination.

By Mr. T. C. Townsend:

Q. Will you please state your name?

A. Joseph R. Kelley.

Q. Where do you live?

A. 21 Allison Avenue, Yonkers, Westchester County, New York.

Q. What is your business?

A. I am attorney and counsellor at law of the State of New York.

Q. With offices in New York City?

A. 60 East 42d Street and at 120 Broadway, New York City.

Q. Were you ever at any time connected with S. E. C.?

A. For a period of months in the early part of 1939 I was temporarily connected with the Securities and Exchange Commission, Monopoly Study Division, part of the time as special counsel in one of the sections and part of the time as financial adviser in the same section of that [fols. 43-44] division.

Q. Are you connected with Fidel corporation in any respect?

A. At the present time I am a director of Fidel Association of New York, Incorporated; and for a period of years past, since the date of its incorporation, I have acted from time to time as special counsel to it, particularly in matters relating to the various indentures under which its collateral trust bonds are issued.

. . . . . .

[fol. 45] Q. Will you tell the Court why, in your opinion, it should be accepted?

A. The principal reason for my opinion is that I look upon Fidel as practically a wasting asset corporation, in this sense of the word. While Fidel was in the market selling or offering for sale its collateral trust bonds, it was replenishing its life stream of new income, so to speak; but since it discontinued selling new bonds it has all of the burdens of management of the collateral trust funds, it has to maintain offices within the State of New York and within the City of New York to receive subscription installments from bondholders and to pay to bondholders what [fol. 46] the bondholders are entitled to receive under the terms of their bonds; and that necessarily means, in turn, that Fidel Association has to keep at New York an agent or officer having at least some executive powers and functions; it must have the services of a consulting actuary at all times; and from time to time it has needed the services of a special counsel—by which I mean myself—because of problems that have arisen under the indentures, the latest of which, of course, was the necessity of finding a successor or substitute trustee within the City of New York to act

in place of the Charleston National Bank, which desired to retire from the business.

Now, while the several bondholders continue to pay in their monthly or periodic subscriptions, it is my understanding that the gross income of Fidel will be sufficient to pay all of the costs of management and the fees of consulting actuaries and counsel and so forth; but little by little, as bondholders either permit their subscriptions to lapse or avail themselves of their cash surrender privilege, or borrow on the amount of the bond and then decide not to pay it back, it necessarily means that the income of Fidel is a [fol. 47] constantly diminishing thing. Furthermore, even if every holder of bonds continued to pay his subscription price, there will come a time in the future when the last bondholder will have paid the last installment and there will be no new income to Fidel from that source then, but there will be perhaps ten years of management ahead of it, and that management, I need hardly add, is almost a sacred trust, because this Fidel scheme comes very, very close to being an unofficial savings bank. They have a couple of million dollars there which represent the savings of several thousand people, most of whom are either poor people, or, to say the least, people who have to save, if they are going to save at all, in small amounts. The management of the trust is going to be supervised; there is no question about that. The Investment Company Division of Securities and Exchange Commission has a certain supervisory and regulatory jurisdiction in the matter, and the New York State Attorney General likewise has a certain supervisory jurisdiction; and that supervision and regulation takes time and money to comply with; it again requires the retention of counsel and consulting actuaries. That is why I say this Fidel looks to me like a wasting asset proposition [fol. 48] as of the date when it had to stop selling, or did stop selling, bonds; and therefore I think this offer to buy it at what is defined in the offer as its liquidating value is a favorable offer from the point of view of Fidelity and its trustee and receivers, and therefore, in my opinion, it should be accepted.

Q. How much, in your opinion, would be realized from this offer?

A. In answering that question I am basing my opinion on the last statement of Fidel Association that I have seen,

which is as of June 30, 1941. In my opinion the amount realized on the sale of Fidel stock should be in the neighborhood of $125,000—perhaps a bit more. As I understand it, the liquidating value is to be determined by Haskins & Sells as of the date when the stock passes and the money is to be tendered for the stock, and of course three months have already elapsed since that June 30, 1941, determination date, but assuming that it is anything near the same that should be the price, in my opinion.

Q. What date did Fidel cease selling contracts in the State of New York?

[fol. 49] A. I have that only on information supplied by Mr. Young, Mr. Townsend, and I think it was as of the first of the year, but it may have been as of the first of December 1940; I am not sure. I may add that it had ceased selling for a considerable time before I found out that it had ceased to sell them.

The Court:

Q. Mr. Kelley, if Fidel is a wasting asset in the hands of Fidelity, is it also a wasting asset in the hands of a purchaser or prospective purchaser?

A. It is my honest opinion that that is exactly what it is going to turn out to be.

Q. Then do you know of any reason why the offer is being made?

A. I couldn't say, your Honor, that I know. I have heard certain discussions in connection with it, largely as pure conversation, which have led me to believe that there have been a numbr of groups of financiers in New York City who seem to think that if they acquire control of the stock of Fidel and thereby acquire control of its board of directors and thereby acquire control, within the framework of the indentures, of the collateral trust funds, that [fol. 50] with their superior knowledge of security values, market conditions, and so forth, that they could so invest and reinvest the collateral trust funds that both the bondholders and Fidel would benefit by virtue of the provisions in the several indentures which permit a division of the excess accumulations in the collateral trust funds as between the bondholders as a class and the corporation, as of the semiannual determination dates fixed in the indentures. Your Honor, I cannot say as a fact that that is the intention of anyone. It is my belief from conversations

that I have heard incidentally over quite a period of time that that idea has been played with by more than one group of financiers; and it is quite possible that either Pell, Ltd. or the people with whom Pell, Ltd. may be associated in this deal, if they bring associates in, have something of the same idea; but, sir, that would not affect the opinion that I have already expressed that it is a wasting asset proposition and it is going to be that even in the hands of financiers, although I say that with due deference to their superior knowledge.

Q. If it were left in the hands of Fidelity, Fidelity would participate in the 50 per cent of thos- excess surpluses, or [fol. 51] whatever it was you called them, instead of the prospective purchaser?

A. That is correct.

Q. Do you have any idea what that would amount to?

A. I have not, your Honor. The only information I have on that point is information supplied to me by Mr. Young several months ago; and he told me at that time that the state of the account as between Fidel Association and the several collateral trust funds was such that there would be no more excess accumulations in the collateral trust funds in which Fidel could participate until something like thirty-eight or forty thousand dollars had been made up in that fund to equalize the credit to which the bondholders were entitled. Mr. Young has also told me—and here again I cannot express any opinion as to the fact myself—that during the years when Fidelity managed Fidel, Fidelity was never inclined to permit free trading, so to speak—investing, selling, reinvesting in the collateral trust fund for the purpose of making a profit. I might also add, your Honor, that I don't think that either the Federal Securities and Exchange Commission nor the State Attorney General [fol. 52] is going to look with favor on any scheme or plan on the part of anyone, no matter how honest it is, to do anything with those collateral trust funds except keep them invested in pretty high-grade things, and once having found high-grade things in which to invest to leave it that way, just to the extent that they have power to supervise and regulate under the circumstances. Again I revert to the thought of practically an unofficial savings bank; you have a fund that does not lend itself to playing with it, if I may use the expression.

Q. Is it your opinion from your knowledge and observation that this offer of the liquidating value is the best offer that can be obtained at this time from any source?

A. Yes, your Honor, I can answer that without qualification or hesitation. I honestly believe it is by far the best offer that can be obtained from any source. I might add in connection with that, your Honor, that there are other factors operative in the case of Fidel that, in my judgment, make it difficult to sell. Fidel was organized for the sole purpose of getting around statutory provisions in the law [fol. 53] of New York that prevented Fidelity from coming into New York on its own and doing business in New York, because Fidelity was and is, according to the banking law of New York, an investment company, and an investment company can't get into New York, be it domestic or foreign, without the permission of the Superintendent of Banks, and the Superintendent of Banks of the State of New York had years ago informally refused permission to let Fidelity in, on two grounds, the first was that he did not have the man power to supervise or regulate investment companies the way they should be, particularly those that were writing cumulative investment certificates of the kind Fidelity was offering, and, secondly, that Fidelity and companies like it came too much in competition with savings banks and savings and loan associations organized under the New York banking law, which offered a comparable service to investors without any load for sales expense.

Anyway, Fidelity couldn't get into New York; and when I was first retained by Fidelity it was for the purpose of seeing whether or not some way could be found to let Fidelity into New York. I tried to get it through the Insurance Department of the State first, and I couldn't, be- [fol. 54] cause it wasn't issuing any contract that had an insurable hazard in it, it was not an insurance company in New York. But there had been a 1929 amendment to the stock corporation law of New York, which controls the organization of ordinary business corporations, which provided that you could form, under the stock corporation law, a company for the purpose of acquiring the bonds, notes and choses in action of other persons, firms or corporations and issuing collateral trust bonds against the security thereof; and while it is pretty obvious that that statute was not intended to permit Fidelity to get into New

York and do indirectly what the banking law prohibited it from doing directly, none the less the State Attorney General rendered, in 1932 I think it was, an opinion approving as being within the law the Fidel setup.

That arrangement was never acquiesced in—that opinion, rather, was never acquiesced in—by the Superintendent of Banks of New York, so that the way the thing stands at the moment, the Superintendent of Banks feels that Fidel does not conform to the statute, the Attorney General is on record with an opinion that it does, and there has never [fol. 55] been a determination as to whether it does or does not. When those facts, you see, are inquired into by any prospective purchaser, the tendency might be to scare them off, because even though Fidel doesn't offer bonds any more, there are provisions under the general business law of New York whereby the State Attorney General could, should he change his mind and become convinced that Fidel was an illegal method of doing business, move for the appointment of what is known in New York as a Martin Act receiver, which would simply take possession of all the assets, liquidate them, and put Fidel out of business, and whoever paid anywhere from a hundred to a hundred and twenty-five thousand for its capital stock would get nothing; the expenses of the liquidation unquestionably would eat up any equity it had.

It is for those reasons that I myself feel from the point of view of Fidel and Fidelity that this is a good offer and, frankly, should be grabbed at.

The Court: Anything else?

Mr. T. C. Townsend: We have nothing, your Honor.

Cross-examination.

By Mr. Palmer:

Q. Mr. Kelley, for what purposes are a consulting actuary needed?

[fol. 56] A. Under the indenture it is on the certificate of the consulting actuary furnished to the trustee from time to time, I think semiannually, that the amount of the required accumulations—in other words, the actuarial reserves—are determined. That becomes the first factor in your equation. Twice a year the trustee receives from the consulting actuary, who must be an independent actuary, although he

may be selected by the company, a certification in which the consulting actuary advises the trustee as to the amount which should be in the collateral trust funds as a reserve for the protection of these bonds as they mature. Then values are ascertained in accordance with formulae set forth in some detail in the indenture and the two figures are compared; and it is by a comparison of the actuarial certification with the indenture appraisement that the trustee may know from time to time whether the collateral trust funds are adequate or whether they are in default to any extent.

Then the next job of the consulting actuary is to make the computations that are required from time to time to determine whether or not there are excess accumulations [fol. 57] in the reserves for division and allocation as between the bondholders as a class and the corporation; and in that connection I might point out that there is a little complication comes in there. When you value the collateral trust securities to determine whether or not the collateral trust fund is adequate in the light of the actuarial figure which has been certified by the actuary, you do not take—here at least—market value into consideration at all. You see, if you have securities in there that are not in default as to principal or interest and are otherwise in good standing, then you can return them at par; whereas when you come to the computation that has to do with the allocation of—no, let's not say allocation—has to do with the determination of whether or not there is an excess accumulation in the collateral trust fund, you shift your base, and you do not use the indenture formulae, but you use market or cost, whichever is lower, or, if there is not any market, book or cost, whichever is lower.

So you see that semiannually you have those three factors that have to be ascertained: (a) the amount of actuarial reserve required; (b) the values per indenture formulae; [fol. 58] and (c) values for determination of excess earnings or excess accumulations in the collateral trust funds.

Then there is another function that the consulting actuary has——

Q. Will you pardon me just a second before you go into that next feature?

A. Yes.

Q. The third one, which provides for division between contract holders and owners of stock, is based upon market value? Is that correct?

A. Market or cost, whichever is lower. At least, that is my unaided recollection of the provisions of the indenture.

Q. Now go ahead. I didn't want to interrupt you.

A. Now, there is a fourth job that a consulting actuary has to do within the framework of the indentures themselves, and that is that as the holders of bonds complete their subscription payments and the bonds become due, then a point of time is reached with respect to that particular bondholder when his right to share in that excess is no longer [fol. 59] provisional, it is definitive and absolute; and then there is another special formula in the indenture for the use of the actuary in working out the ratios and to the last penny the share in that accumulation that that particular bondholder should have.

Then the other respect in which I know that the services of a consulting actuary are needed is that, ordinarily at least, when you want to explain this scheme to anybody, you have to have an actuary, because there is a point beyond which I can't take you. I know the legal aspect of it fairly well, because I drew the indentures, but I would not even attempt to express an opinion about the actuarial complications of it, because I don't know.

I might add, too, of course if there is ever occasion to put out new indentures—and that seems to be out of the question now—you obviously need one then; he has to collaborate with you in getting the indenture.

Q. Mr. Kelley, at the end of any semiannual period, as I understand it, on market value there is determined whether or not there is an excess in the fund, and if there is an excess 50 per cent of it goes to the general or stockholders' fund and 50 per cent is retained in the fund for the benefit of [fol. 60] the contract holders. Am I correct in that?

A. It is correct with this one qualification. There is a further provision in the indentures which limits the right of Fidel to participate in that fund under certain circumstances. If you care to, I have that stuff here, and I will be glad to read to you that particular sentence which embodies that qualification.

Q. All right, sir.

A (Reading): "Provided, however, that the aggregate share of such excess credited to the account of the Association at any time shall not be increased by current allotment upon any determination date to an amount greater

than the aggregate share of such excess provisionally credited to the account of the registered holders of such bonds as a class at the same time."

Q. What does that mean, Mr. Kelley?

A. I might say in the beginning that that was the language of the actuary, not the lawyer; but it is my understanding that that means this. If, on a given determination date, let us say January 1 in any year, it appears that the bondholders provisionally are entitled to x dollars and Fidel is entitled [fol. 61] to and takes x dollars, and in the ensuing six months something happens to the market value of the collateral trust fund, that the provisional credit for the benefit of the bondholders is either wiped out or diminished. Then Fidel can participate in the second ensuing determination date only after what the provisional credit for the bondholders lost in the first six months of the period has been made up in the second.

Now, that is my understanding. I can only say that is what I thought it meant when it was incorporated in the indenture; and my later discussions with Mr. Young have led me to believe that that also is his understanding of it. Otherwise, you see, it would be impossible to explain the fact that Fidel can't participate in this excess for some period of time to come until the provisional credit for the bondholders has been built up to the extent that he told me of $38,000.

Q. The legal interpretation of that key sentence would be on the determination whether or not anyone who bought it out could continually draw out their profits, even though the bondholders might not be getting a profit? In other words——

A. Yes, that is my understanding exactly.

[fol. 62] Q. And if your understanding of that key sentence would be wrong and it would be interpreted otherwise, then the stockholders could make a profit more or less even though the bondholders were losing money?

A. Oh, sure. In effect, then, you would be perpetrating a fraud on the public, because in my opinion you would have no right to take the money of the public without advising them in writing exactly the way you were going to run that fund and then let them buy it if they want to.

Q. But if the person who bought this out should obtain a legal decision that the interpretation you have given us is not correct and that they could continue to take out profits,

then it would be a very advantageous thing for anyone who bought the stock of Fidel, wouldn't it?

A. Yes, but, again, there are qualifications to that, because, to begin with, the indenture trustee; whether it has the right under the indenture or not, has certain ideas of its own as to how these funds should be managed, and of course the indenture trustee is the one who has this property. If [fol. 63] the indenture trustee is not satisfied that the administration of the fund is in accordance with its construction of the indenture, it wouldn't do anyone a great deal of good to try to do something which they thought would be more advantageous to them, because the indenture trustee has too many powers. The indenture trustee would unquestionably under those circumstances apply to a New York court for instructions to determine the question. I haven't the slightest doubt that there would be both state and federal agencies who might interest themselves in it; and I honestly think it is impossible for anyone to make money for himself on the operation of these collateral trust funds, irrespective of any opinion of counsel you may get about the contract; there are too many people in existence to stop them; whether they have the right to or not they they will.

Q. What would prevent the new stockholders from getting a new indenture trustee who might be more to their own liking?

A. Well, theoretically, nothing. Actually there always has been serious difficulty in getting indenture trustees in New York City to act under these indentures for a variety of reasons. Back in 1932, when the first of these indentures [fol. 64] was written, Fidelity tried to interest three or four trust companies in New York City of Different sizes in the trusteeship, and the trust companies uniformly refused. Their reasons ran something like this: "We never saw anything like this indenture before, and have never been in this particular type of kind of business, and no matter what the State Attorney General says we are not sure about its validity or legality; and, secondly, we don't like to get into this installment contract business anyway; we are not geared for it;" and, finally, this scheme does unquestionably, you see, some directly into competition with the business of savings banks and savings and loan associations and the thrift departments of commercial banks, and for that reason, if for none other, it was not favored.

Anyway, we couldn't get a trustee in New York if we wanted to, and, fortunately, the Charleston National Bank examined into the business and found it acceptable and carried on for a number of years. Then, when it seemed desirable again to get the thing back in New York State, at the urging of state officials and others, Mr. Young was able to persuade the president of the Colonial Trust Company, [fol. 65] which is quite a small institution, to accept the business. The business was duly accepted, but it is far from easy to get a new trust company to take on a type of business of this kind, with which it is wholly unfamiliar, over and above all of which it is rather expensive, because, you see, every time you shift your trustee you have to pay a new acceptance fee to the trustee, you have to pay the fees of trustee's counsel, a lot of documents have to be prepared—It is quite a job, and there is plenty in it to discourage anyone that would try it, although theoretically there is nothing to stop them.

Q. Mr. Kelley, did I understand you to say that Mr. Young had told you that the Charleston Trust Company, when it was trustee, would not permit the manipulation of the securities in the portfolio for the purpose of trying to make a profit by buying and selling them?

The Court: Charleston National Bank.

Mr. Palmer: Yes; it was the trustee.

A. If I said the Charleston National Bank in that relation I was in error. I don't think I did. What I meant to say, and what I think I did say, is that Mr. Young has ad- [fol. 66] vised me from time to time that Fidelity would not permit the free investment and reinvestment there; unless it got good security in the collateral trust fund it wanted to freeze it there.

Q. And it came out solvent by doing that?

A. I am convinced that Fidel is comfortably solvent and I am also convinced that the conservative investment policy had a lot to do with it.

Q. Now, these gentlemen who want to purchase it, it is your understanding, would like to do what Fidelity would not permit to be done, buy and sell and exchange the securities in the hope of making a profit by manipulation whereby they can buy at one price and sell at a different price?

A. Well, I couldn't say that that was my understanding with respect to Pell, Ltd. specifically or about any specific

group that might become associated with them. All that I can say in that connection is that over a considerable period of years I have heard conversation and discussions about the possibility of doing that. Of course, whenever I did hear it discussed, the point was always made by someone, [fol. 67] and I think rightly, that no one can make money out of the investment and reinvestment of that collateral trust fund over any period of time without making it for the benefit of the bondholders as well, because to the extent that it is made it means that you have an excess accumulation in the reserve from time to time in which Fidel and the bondholders share equally, the difference being that Fidel takes it out, whereas it provisionally remains in there for the bondholders, and the individual bondholder gets his share only as, if and when he completes his subscription payments.

Q. The $125,000 approximately that would be paid for the stock, would that include any of the undivided profits which existed at the time of the sale in the funds?

A. Well, it would certainly be my understanding that it would, if such existed. It is, however, my understanding that none such exists, and I paid no further attention to it for that reason. It is not theer, so I have not paid any further attention to whether it would pass it.

Q. The person who paid $125,000 for it would have ample security for his $125,000 by buying it at liquidating values? Isn't that correct?

A. Well, I think so, if my understanding of the nature of [fol. 68] the securities in which Fidel funds are invested is correct. I understand that they are conservative and reasonably high-grade securities, and barring some sort of financial debacle that would upset the whole nation I suppose that anyone who buys at liquidating value will certainly have reasonable security, subject always to this point, however, that as the years go on, unless he is able to make money either out of investment and reinvestment of the general fund or the investment and reinvestment of the collateral trust fund, or both, he is going to suffer from this wasting asset situation that I referred to earlier in my testimony.

Now, of course I realize I am under oath, and I am projecting myself into the future; I am expressing opinions. That is the way it strikes me.

Q. Mr. Kelley, it amounts to this, does it not: A group put up $125,000 which at the present time would be adequately secured, and with that, because they put up $125,000 which is perfectly secured to them, they are given two million dollars of someone else's money with which to gamble and hope to make money; the most they have to lose is [fol. 69] $125,000, and if they are successful in the years of gambling with other people's money, then they can make a very comfortable profit for themselves and those other people equally?

A. Of course, they do have to operate within the framework of the indenture. That being so, I don't know whether "gambling" is the word. You see, these indentures are not set up to permit of the inclusion in the collateral trust funds of common or preferred stocks, so that takes a couple of the choicest vehicles for gambling right out of the operation to begin with. You see, you are dealing with bonds, notes, and, for want of a better term, choses in action, because that is the term used by the New York stock corporation law, but I have from time to time definitely rendered opinions to Fidel and to others connected with it that, as used in the statute and as used in these indentures, the term "choses in action" does not include common or preferred stocks, guaranteed or otherwise.

Q. Mr. Kelley, whether you call it gambling or not, the only purpose that anyone could want to do this would be for the purpose of buying some form of securities low and selling them high and thereby making a profit which they would share equally with the contract holders? Isn't that [fol. 70] true?

A. For the immediate future that would not necessarily be true, because for the immediate future a person who took over Fidel now might reasonably expect to have the benefit of continued subscription payments by the holders of bonds; but you do reach a point in the future—and I honestly can't tell you how far distant that points looks to me at the moment; I don't know, but it is there—you do reach a point in the future where the income to which the general fund of Fidel would be entitled out of the periodic subscription payments would in all probability be insufficient to pay the expense of maintaining and managing Fidel and the collateral trust funds; so that it does seem to me that over the long term—over the long view here—the only

chance that anyone has of making money out of a purchase of Fidel would be a pretty skillful operation of investing and reinvesting the collateral trust funds. I say it must be skillful because one mistake of a serious nature would have the enterprise insolvent at the next determination date, whereupon, of course, the indenture trustee would proceed immediately to liquidate immediately, either under the powers [fols. 71-76] reserved in the indenture or by application to a court for the appointment of a receiver.

. . . . . .

[fol. 77] Q. Well, if, over a period of years, the contract holders cash-surrender their contracts, there is a theoretical or book profit set up in the fund by virtue of the difference between the reserve and the cash surrender value? That is correct, isn't it?

A. I think that is correct, Mr. Farmer.

Q. I am Mr. Palmer. Mr. Farmer is over here.

A. Oh, I am sorry. I think that is correct if the liquidation of those bonds by the several bondholders is done over a period of years and not as part and parcel of a general liquidation as of a given moment of time.

Q. If it is done over a period of years, so that every contract holder cash-surrenders, then the stockholders not only get the entire fund, because there are no contract holders to get 50 per cent of any appreciation profits, but they would also get the entire fund and have any profit made by the [fols. 78-81] difference between cash surrender and reserve? Isn't that true?

A. That sounds right to me, but again there is an adjusting factor that makes me qualify my answer because, you see, just to the extent that people come in with their bonds for cash surrender, and from theoretical—at least, the position of Fidel with respect to the surpluses in the collateral trust fund, Fidel is losing the benefit of the periodic monthly income from those same persons. That is why I find it hard to answer you, you see, categorically, yes or no. There are too many ifs and ands here, and I can only say I don't know.

. . . . . .

[fol. 82] Q. Now, by wiping out this liability, or the guaranty of Fidelity to Fidel, the bondholders of Fidel would gain nothing by letting that be wiped out, would they? They

have something now, regardless of whether it is worth a little or worth nothing. They wouldn't gain anything by having it wiped out?

A. Completely discharged, you mean?

Q. Yes.

A. Without any quid pro quo at all?

[fol. 83] Q. Yes.

A. When I said that I really had in mind a wiping out by bankruptcy discharge after the failure of any attempted reorganization. I didn't mean a wiping out with their consent. When I spoke of a readjustment downward to a more or less nominal figure, I did have in mind the readjustment of a reorganization, either in this Court or a state court, which would require, in some manner, shape or form, the consent of the requisite number.

Q. So Fidelity, if it got $125,000 cash now, has the almost certain potential liability in the future of its guaranty to Fidel, because, as you have told us, Fidel is a wasting asset, and in the future will be a liability to someone, so if the guaranty remains Fidelity contract holders, although they get $125,000 for the general kitty, are going to have that potential liability in the future? Isn't that right?

A. Unless it is properly cared for in a plan of reorganization—oh, definitely.

Q. I notice you said when these bondholders of Fidel have taken their contracts and paid upon them, that there is an executed contract with Fidelity which puts this guaranty [fols. 84-90] into effect.

The Court: That is a legal conclusion, Mr. Palmer, which this witness, although he is a lawyer, is not qualified to answer in this proceeding.

Mr. Palmer: He has been giving, your Honor, as I understand him, legal conclusions.

The Court: There has been no objection up to now, but I cannot permit such a clear legal conclusion as that. That is a matter for the Court to determine.

. . . . . .

[fol. 91] The Witness: During the recess certain figures have been shown me by Mr. Palmer, and I have examined [fol. 92] them, and I have been asked to state these figures for the record and to make any comment in relation to the figures that is relevant to the opinion that I have expressed

that it is to the best interests of Fidelity that the offer be accepted.

The statement was captioned, "Adjustments to bring book surplus of market surplus over net cash liability," the date being as of June 30, 1941.

Now, what follows is with respect to Series A bonds. It appears from this statement, which in turn appears to be correct as per the published financial statements of Fidel as of June 30, that the surplus per the books, based on book value of investments and actuarial reserve, is, for the unmatured bonds, $110,293.57, and for the matured bonds, $519.46, the total being $110,813.03; and the deficit represented by a comparison of market to book values of investments is shown as follows: in the unmatured fund the book value is $973,509.94 and the market value is $915,526.63, the indicated difference between book value and market value being $57,983.31, which is a deficit in the sense that market value is below book value by the amount indicated.

[fol. 93] With respect to the matured fund the book value is $6893.60 and the market value is $7315, so that with respect to the matured fund the market value exceeds book value by $421.40.

From the same source this statement indicates that the excess of the actuarial reserve over the net cash liability is made up as follows: actuarial reserve is $981,436.52, net cash liability is $954,098.03, the excess of actuarial reserve over net cash liability being, therefore, $27,338.49, and the market surplus over net cash liability is $80,589.61. Now, so much for Series A.

And referring again to the statement supplied by Mr. Palmer, now with respect to Series B bonds, the surplus per the books based on book value of investments and actuarial reserve is, for the unmatured bonds, $20,683.14, and for the matured bonds, $2163.15, the total being $22,846.29. With respect to the market value over book value of investments, the detail is as follows: in the unmatured fund the book value is $1,248,207 and the market value is $1,254,820, the excess of market value over book value being $6613. In the matured fund, the book value is $60,996.50 [fol. 94] and the market value is $50,537.50, the market value being less than the book value by $10,459, which is indicated here as a deficit in the sense just explained.

The excess of the actuarial reserve over the net cash liability with respect to the Series B bonds is stated as

follows: actuarial reserve, $1,598,822.01; net cash liability, $1,548,703.59, the excess of the actuarial reserve over the net cash liability being $50,118.42; and with respect to these series B bonds the market surplus over net cash liability is $69,118.71.

Now combining the market surplus over net cash liability of the Series A and Series B funds, there is an aggregate market surplus over net cash liability as of June 30, 1941, of $149,708.32.

Now from my knowledge of the indenture and the figures—the correctness of which, incidentally, seems to be beyond dispute on the part of anyone, because they are taken from the published statement of Fidel—what I have read, after discussion with Mr. Palmer in the recess, amounts to this:

If every bondholder of Fidel should cash-surrender his bond under circumstances that would not entitle the sur- [fol. 95] rendering bondholder to actual participation in the surplus accumulated in the several collateral trust funds, and all other things remaining equal, there would be $149,708.32 of market surplus over net cash liability, which should be added to the stated net worth of Fidel Association as per the balance sheet of its own general fund, meaning the fund of free assets not subject to the collateral trust indentures.

Mr. Palmer:

Q. Mr. Kelley, could I interrupt you a minute?

A. Surely.

Q. Then, under these circumstances, the particular offer should be approximately $125,000 as to surpluses of the general fund, plus $150,000, as you have given it, or a total of $275,000? Am I correct?

The Court: Let's wait, before that question is answered, till the witness qualifies what he has said. I think I can see several qualifications, and probably the witness knows a good many more than I do.

The Witness: Actually, your Honor, I think Mr. Palmer's question may have been designed to bring out a couple of [fol. 96] those qualifications, so that there may be no distortion of the picture one way or the other. The first qualification that I have to offer with respect to the picture made by the figures just read into the record is this, that

just to the extent that bondholders of Fidel come in and surrender their bonds, the income which Fidel would expect, and might reasonably expect, to receive from those bondholders by reason of the continuance of their subscription payments in the future would become non-existent; so it would seem to me that that figure of $149,708.32 must be offset by some indeterminate amount which, if it could be determined, would be the present value of the prospective income that Fidel might normally expect to receive from the contributions made by its bondholders. By contributions of course I mean the installment payments under their subscriptions to their bonds.

In addition I think this qualification must be adverted to, that there is no way that I know of under this indenture in which bondholders could be required, under any circumstances, by any permissible action on the part of Fidel, to come in and accept their cash surrenders, so that the exist-[fol. 97] ence of this figure of $149,708.32 as an actually realizable addition to the net worth of Fidel is wholly contingent upon an accidental circumstance that within a measurable period of time in the foreseeable future every bondholder will come in and cash-surrender his bond, all other things reflected by the statements as of June 30, 1941, remaining substantially equal.

The Court:

Q. As I understood your answer, these values that go to make up the hundred and forty-nine thousand odd figure also include the difference between book values and market values of securities, don't they?

A. Yes, sir, those conditions are all reflected in that ultimate figure of $149,000 plus.

Q. So that, on a present day basis, if the securities were liquidated there would be no actual value in that difference that you have set up there which goes into the $149,000, insofar as the difference between the book value and the market value of securities was concerned?

A. Your Honor, that has already been taken into account in this way, you see, that in arriving at the two subtotals that go into $149,708.32, the deficit of market value in relation to book value has already been deducted, so you see that full effect has been given to that; so it is [fol. 98] true to say that if, within a measureable period

of time in the future, everything else remaining substantially the same as it is per the statements of June 30, 1941, all Fidel bondholders came in and voluntarily cash-surrendered their contracts, $149,708.32 would be added to the net worth of Fidel; but as against that all of Fidel's income, its good will as a going concern, and all of the incidents to that status would vanish.

Q. Yes. Go ahead.

A. So that I shan't appear to be in the position of unduly favoring my own opinion that this offer should be accepted, I think I should add that if there is any chance of anyone paying anything for the stock of Fidel in addition to its net worth on the contingency that some—not that some but that all the bondholders will come in and do this, then if such an offer were before the Court I most certainly would recommend that it be accepted and that the Pell, Ltd. offer be rejected.

Mr. Palmer:

Q. Mr. Kelley, do you know that within the last six months, I believe it was testified to here, $600,000 of face amount certificates had been cash-surrendered?

[fol. 99] A. I didn't know the exact amount, but I did know that from time to time between the date of the institution of the state court proceeding in West Virginia which resulted in the appointment of the receivers and the present time there had been, on specific occasions, exceptionally large cash-surrender demands, but the amount, $600,000 or some other figure, I could not say.

Q. And if that present rate continued it would only take two or three years until this very contingency that we have been speaking of would happen and all of the policies would be cash-surrendered? Isn't that true?

A. If that rate continued?

Q. Yes.

A. Oh, yes.

Q. Would it be your thought, Mr. Kelley, that before the Court should accept this offer it should see if there are any other persons who might be interested, because of this figure of $150,000 approximately extra that might be made by anyone if this cash-surrender process continued?

The Court: Well, I can say, without the necessity of the witness answer- that question, that the Court would certainly do that. The Court would require the Trustee, before [fols. 100-116] accepting this offer, to ascertain by all possible means whether there could be any better offer secured from any source.

Mr. Palmer: I presumed that the Court would, naturally. That is all, Mr. Kelley. Thank you.

. . . . . .

[fol. 117] A. G. Swiger—Cross.

Mr. Farmer: That would be true if I could tell if those companies were investment companies.

The Court: This witness has said he doesn't know anything about it except what is on the sheet. Now you ask what is on the sheet. It is already in evidence. Let's get through with this. Objection is sustained to that question.

Mr. Farmer:

Q. Do you mean, Mr. Swiger, that you don't know which of those companies are investment companies?

A. No, I do not, and for this reason, Mr. Farmer. I presumed when I came to Charleston and when this offer was submitted that the Court and counsel would want to know who these parties are and something about their responsibility. I requested each of the directors of Pell, Ltd. to give me a list of their companies which they served as director and executive and so forth, and this, referring to Mr. Stewart's, is Mr. Stewart's own list, which he gave to me and which I have copied into this memorandum.

Q. Now, as to Mr. Pell, you don't know what companies [fols. 118-119] he has listed there are investment companies?

A. No, I wouldn't know.

Q. You didn't bring with you a balance sheet or financial statement of Pell, Ltd., did you?

A. No, I did not.

Q. Sir?

A. But I want to reiterate that Pell, Ltd. doesn't have sufficient money in its treasury today to buy and pay for the Fidel stock, but in the same way, with as much emphasis, if this offer is approved by the Court, Pell, Ltd. will keep its commitments.

Q. And it has not been decided which of these gentlemen would contribute towards the fund necessary to consummate this purchase or in what proportions?

The Court: It doesn't make any difference, Mr. Farmer.

. . . . . .

[fol. 120] Mr. Palmer: There was some controversy, your Honor, as to the question of fees—the size of his fees—your Honor, and this witness being intimately acquainted with him for twenty years and being a member of the bar of New York and knowing financial men, would have a very definite idea as to Mr. Koontz's worth to Fidelity and what he did with reference to it in a definite way in New York.

The Court: If he knows anything with reference to the immediate services for which the fees were charged, I will permit him to answer the question; otherwise I will sustain the objection.

Mr. Hillis Townsend: Your Honor, this question and answer are to become a part of the main record? Is that right?

[fols. 121-122] Mr. Palmer: Yes.

Mr. Hillis Townsend: It is not a part of the record on the Trustee's petition?

Mr. Palmer: No, not at all.

The Court:

Q. Do you know anything about these particular services that Mr. Koontz rendered to Fidelity?

A. Your Honor, I wouldn't know unless I would see his bills and see what services he had charged for. I do know this, in fairness to Mr. Koontz, I should say, that I saw him frequently in New York over a period of years. He was in my office many times. He conferred in my office with various people with reference to the affairs of the Fidelity Investment Association. He seemed active in that connection. From my opinion as a lawyer, I would say he did a very good job.

. . . . . .

[fol. 1-62] Mr. Palmer: Here is the one I have, your Honor, which was made December 27th 1941, giving notice for Monday January 5th 1942 at ten A. M. "or as soon

thereafter as counsel can be heard," and the motions were brought up on the 5th and later set for hearing today.

That motion is this: "Comes L. H. Brooks, trustee, Frederic Leake and A. L. Goldberg, Jr., trustee and move the Court to order the Central Trust Company, trustee, forthwith to make and file a report in pursuance of Section 167 of the Bankruptcy Act as amended as to the desirability of the formulation of a plan of liquidation in accordance with the suggestion or suggestions copy of which is attached hereto and made a part hereof."

Then they have the plan of liquidation.

Then I have another motion here.

"Come L. H. Brooks, Trustee, Frederic Leake and A. L. Goldberg, Jr., Trustee, and move the Court to order the Central Trust Company, Trustee, forthwith to make and file a report in pursuance to Section 167 of the Bankruptcy Act as amended as to the desirability of the continuance of the Debtor's business, said report to be filed before the Court's decision on the issues now under advisement is [fol. 63] announced and order thereon rendered."

That was accompanied by a memorandum of authorities.

Then I have another motion here by the same persons moving the Court for an order restraining the Central Trust Company from sending out any notices to the policy holders until there has been a division of the creditors into classes, and further that no order be made with regard to filing the claims until there has been a hearing on the motion heretofore filed requiring the trustee to file a report in accordance with Section 167 and 169 of the Bankruptcy Act.

The Court: Before we take up those motions, let me reiterate what I said a few minutes ago, if it was not entirely plain, and that is that I don't propose that the administrative procedure in this case be carried on as a result of motions made by contract holders unless it has first appeared to me that the trustee is in some way lacking in the discharge of its duties; and so before we take up any of these motions I want the trustee to explain what procedure he has in mind, so that I will know whether or not these motions are in order.

Mr. Hillis Townsend: Your Honor, we are very glad to [fol. 64] have that opportunity, and had intended to speak at the proper time.

If the Court please, counsel for the state court receivers and Mr. Farmer have made motions which require more specifically than anything else that the trustee file a report expressing its opinion as to the desirability of the continuation of the debtor's business. The trustee does not believe that this act contemplates a report which contains an opinion on that point without submitting along with it the facts found by the trustee which would justify that opinion. There are several ways in which the administration of this estate might be proceeded with, and the trustee has had to consider a number of different things in formulating, in its mind, the proper plan to follow. Section 167 (1) provides that the trustee shall make certain investigations and report on them to the Court including an expression of the desirability of continuing the debtor's business.

The Court: The report is to the judge.

Mr. Hillis Townsend: To the judge. Section 167 (5) requires that the trustee make a similar investigation and send notice thereof to the contract holders in the form and [fol. 65] manner prescribed by the Court. I might clear up one of Mr. Farmer's motions and Mr. Lauritzen's objection here right away by saying that at the present time the trustee does not plan to ask the creditors to send in proofs of their claims, and before that is done these parties will be notified and have ample opportunity to present their objections to the Court, but they can dismiss that for the time being, because the trustee does not plan to do that immediately.

The Court: Just what is the plan of the trustee with reference to having the Court pass on these claims?

Mr. Hillis Townsend: This is it. I will be to that in just a moment.

The Court: All right.

Mr. Hillis Townsend: In order to file the report required by Section 167, or for that report the trustee has a great deal of the information required by it. Briefly, this is what the trustee plans to do. It would like to file, and it agrees with counsel who have raised this question that perhaps the time has now come when certain of this information should be filed with the Court and certain of this information should be sent out to the contract holders; but [fol. 66] we are trying to bear in mind that mailing notices to contract holders is expensive in this case, and as many

of them are to be avoided as possible, and the trustee is in position, or will be within a very short time—and we would like for the Court to suggest a date, or perhaps we can agree on a date here—in which it can file a portion of the 167 report which will contain an expression as to the desirability of continuing the debtor's business and a great many other of the facts that are required by those sections.

Of course your Honor doubtless knows that the cloud that hangs over the administration of this trust is the appeal that is pending in the Circuit Court of Appeals. Some of this procedure is going to be expensive, regardless of exactly what form is adopted and regardless of when it is done. The trustee has been very mindful of the fact that if a lot of money is spent in an expensive procedure for the classification of claims and the determining of the rights of creditors, and then the jurisdiction of this Court is vacated by a decision of the Circuit Court of Appeals, that money is gone and no good will have been done; and we disagree with counsel that that would be information [fol. 67] which might be used by any other Court that took jurisdiction of this case. So the trustee, therefore, has not believed it advisable to enter into this claim procedure before or at the time of filing and submitting the greater part of the 167 report. It would like to do that first and can do that and will do it within any short time of a few weeks which might be settled on here today, and as I say that report will contain the trustee's opinion about the desirability of continuing the business; and if these gentlemen want to use that, and think they can get it into the record properly before the appellate court and want to use it, the trustee will certainly have no objection to it going into the record.

After this information is before the Court which is required by Section 167, it then becomes the duty of the trustee to send this information to the creditors, and they, as I understand the law, in the light of this information, are entitled to submit a plan. Obviously a plan can't be submitted until this 167 report is in and this information is sent to the creditors and they have had their opportunity to submit proposals for a plan. Therefore no plan can be [fol. 68] submitted by the trustee until that has been done, and we think that the classification of the creditors can more properly be decided by the Court in connection with the

Court's approval of the plan, because if it is done that way it might obviate one more appeal in this case. We think that there will doubtless be an appeal from the decision of the Court on the question of the classification of creditors, and we think also there probably will be an appeal on the question of the adoption of a plan or approval of a plan by the Court. Now, if the trustee can proceed in such a manner as to get this question decided at the same time and in the same proceeding before this Court, then those appeals can be combined and decided at one time and whatever proceeding is ultimately adopted could go ahead from that point.

That, briefly, states the plan which the trustee has in mind, and we are willing to have the Court fix any time within say four to six weeks or so within which the most of this—two months would perhaps be better—for the balance of this 167 report, except as to the recommendations as to the formulation of a plan.

We can't help but have some feeling over the fact that [fol. 69] counsel have repeatedly stated here in court that the trustee has been ordered to do something which it has failed to do. We don't think that any orders have been entered directing the trustee to file this report or any part of it. Your Honor has expressed your opinion as to when those things should be done on two or three occasions; and I think it is proper to say that those expressions were made at a point in this proceeding where none of us knew the course that it would take.

Another thing which comes to our minds in this connection is this. This criticism comes from the state court receivers, who have filed an appeal from your Honor's decision taking jurisdiction of this case. They are the ones, and the only ones, that have voiced any criticism of the course that has been pursued by the trustee. None of the creditors have complained that I know about, and some of the creditors have promptly expressed their approval of the method. If any expensive procedure is engaged in by the trustee at this point, as they seem to think it should be, and they prevail in their appeal, then that will negate anything that is done at this time; and we can't quite appreciate [fol. 70] the position that they take in insisting that the trustee do something which they, by prosecuting the appeal, would undo if they prevail on their appeal. That, in brief, is our position at this time.

Mr. Warner: May I say a word, your Honor?

The Court: Yes, Mr. Warner.

Mr. Warner: On behalf of the creditors whom I represent, I think that the trustee should do nothing except routine work and administrative work. He would be subject to criticism by contractholders if he incurred extraordinary expense here for nothing. I am advised it will cost around $25,000 to have an audit made. It will certainly take a lot of time. It will take a lot of time of attorneys and plenty of expense to classify the creditors and formulate a plan; and it all may result in nothing at all if the Circuit Court of Appeals vacates the order of this Court. I think the trustee would be subject to criticism if it incurred any unnecessary expense without a specific order of this Court.

Mr. Eney: I have listened, your Honor, with a great deal of interest to what Mr. Townsend had to say. As I understand him, what he suggests is that the trustee will, except [fol. 71] for purely administrative matters, stay the proceedings pending the appeal. If that is the considered opinion of the trustee I won't quarrel with it, although I had rather anticipated that the Court, having decided the question of jurisdiction, would go ahead. There are two things, however, which occur to me as being questions which necessarily must be determined by the Court before any effective work can be done for developing a plan of reorganization or determining that any such plan can be developed. Those questions are a number, but they can be divided into two classes. First, the method or the manner in which claims of contract holders shall be computed. I don't feel that the trustee can possibly make any plan or formulate a plan, nor do I believe any creditor or creditors' committee could formulate a plan, without having some basis for the classifying of the claims. We have talked glibly of cash surrender values of the contracts. I, for one, think that is not a proper method of classifying the claims. I don't think cash surrender value is proper, because it cuts out a large number of creditors who had no cash surrender values, but who are in no wise in default.

[fol. 72] The Court: Who are they?

Mr. Eney: The people that paid less than eleven months.

The Court: They would have equity in the case of reorganization on the basis of a face amount certificate com-

pany, but would have no equity in case of liquidation, either sudden or slow and orderly. Is that right?

Mr. Eney: I don't think so. That is the view that has been talked about in the proceeding, but I don't personally believe it is right at all. I may be wrong, but it seems to me that that group of persons, people who have not broken their contracts, I don't believe it is equitable for the Court to say to them, "You are just out; you have no claim, because you have been contract holders and paid in for ten months, whereas someone else has paid in for twenty months." But whether I am right or somebody else is right, the Courts can determine whether it is on the basis of cash surrender values, on the basis of reserve values, on the basis of amounts paid in, either discounted or improved at the lawful rate or just flat amounts paid in, or what personally I think is an entirely different theory and [fol. 73] a proper one, which I have discussed with counsel for the trustee. I won't stop to go into it, but I think the Court must at some time in this proceeding determine, not for each particular contract holder, but all contract holders that their claims shall be computed in accordance with a certain formula, a uniform formula.

The Court: Do you believe that an order determining those things would be an appealable order?

Mr. Eney: I don't think an order determining that alone would necessarily be an appealable order, no, sir. I think that in connection with the other question I am about to mention it might be, and that is this. The act provides, and necessarily so, that the Court shall determine what creditors are secured and what are unsecured, and what creditors, who, while not secured, have priorities, as for instance, the United States Government tax claims and perhaps, others; and in addition to that the Court is required to fix a time for hearing and for determining whether or not certain creditors are or are not secured, and to value the amount of their security and determine the extent to which it is secured and the extent to which it is unsecured. In this particular proceeding, in view of the contentions made, that [fol. 74] seems to me to mean that the Court must say with respect to Maryland, for instance, "I am going to fix a day for a hearing to determine whether the Maryland law makes contract holders in Maryland secured creditors, and if I determine that the Maryland law does make them secured creditors to the extent of the deposit there, then I am going

to value that deposit and determine the liabilities in Maryland and to say that creditor is to a certain extent secured and to a certain extent unsecured."

In doing that, in order to determine the liability side of that question, the Court would have, either at that time or prior thereto, to have fixed the manner in which the claims shall be calculated. That involves not necessarily a series of hearings; it can be done in one hearing; but it would involve a separate consideration as to each state. Your Honor might very well say that Wisconsin contract holders are secured and Maryland contract holders are not. In addition to that you have got the question of who are the Maryland contract holders who are secured by the Maryland statutes, if you determine that some are; are they the contracts that were sold in Maryland? Are they holders [fols. 75-81] of contracts who now reside in Maryland, or just who are they? I think those questions must be determined before the trustee can act, because in formulating a plan the trustee, under the case of Case v. Los Angeles and others, no plan can give a contract holder less than his legal right, so necessarily the Court must say what the legal right of the contract holder is, $x$ dollars, in order to guide the trustee as to the minimum that can be allowed that particular one individual in any plan of reorganization. Even though it is approved by every contract holder but one, that one contract holder could upset the plan if his contract is cut below its legal minimum.

What I had in mind is this. I understand that the trustee is about to mail out communications to contract holders at the present time. I don't know how much it costs to mail notices, but it certainly must cost twelve or fifteen hundred dollars in postage alone, plus other expenses.

. . . . . .

[fol. 82] Mr. Eney: One other thing I wanted to say, and that is I don't see how the trustee can make a report which would indicate the specific participation of each creditor or class of creditors in any reorganization, but the trustee has indicated its opinion, and it seems to me reasonable that the trustee could file a report indicating the possible framework of a plan, leaving to the determination of this Court on a hearing the specific participation that each creditor would have in that plan.

. . . . . .

[fol. 83] Mr. Palmer: I think there is a difference of lan-
[fol. 84] guage. What I meant was the listing of creditors into classes, for instance, series classes or state depository classes. However, that is not so important as the 167 report. At that time there was a discussion as to the 167 report being filed in its entirety, and Mr. Townsend said there was no order entered on it, but the Court, in the record, stated.

"I did not remember an order had been entered requiring the filing of a report under Section 167 today, but by September 5th."

But the Court, in that same hearing on August 5th, went on to state,

"I am going to extend the time now for filing the 167 report to October 5th, and the time for the suggestions to be filed with the trustee on the plan to November 5th."

On October 5th there was a further discussion, and Mr. Farmer made an objection to extending the time. The Court, however, extended the time for filing the 167 plan to November 5th.

At the discussion on August 5th the trustee said they wanted six months. Mr. Reinhardt, Mr. Lauritzen and the Court said at that time, which was true and is still true, [fol. 85] that if this company was ever to be reorganized that time was of the essence, and the Court for that reason indicated that if there was to be a reorganization the trustee would, of necessity, have to get his 167 report in promptly, to be followed within one month by suggestions from the contract holders as to the formulation of a plan.

November 5th came and went by and December 5th came and went by, and the trustee was inquired of by me personally as to the filing of the 167 report. That 167 report is of vital importance in this appeal. If it shows that the debtor should not now continue its business, which I think is undisputed by anyone that it should not now continue its face amount securities business, although the court order of June 5th says it shall continue that business and that order has never been changed; the trustee is authorized to continue the debtor in business and there has never been any change in that order.

The Court: Continue the debtor how?

Mr Palmer: It just says to continue in business.

The Court: I would like to see that. I don't know what you refer to.

Mr. Palmer: I think I have the exact order here.

[fol. 86] The Court: I am sure there wasn't any order of this Court that the debtor continue to go ahead and sell contracts, if that is what you mean.

Mr. Palmer: In the second page of the order approving the debtor's petition, entered on June 6th, it was ordered that the trustee give bond, and so forth, and "subject to the authorization and control of this Court, shall carry on, manage, conduct and operate the business of the debtor in its usual course."

The Court: Well, we have never done that, and we have never had any idea that it was to be done, and if there was any question about that and it had been called to the Court's attention the Court would have long ago clarified it; but that didn't and doesn't mean that the business of this concern is to be carried on; they never have carried on any business under this Court except that there have been some payments received and segregated and many of them returned to the persons who sent them in.

Mr. Palmer: I think your Honor, the trustee and ourselves are in full accord on that. However, Mr. Farmer's point is this: that order was entered, and he has repeatedly asked that the trustee file a report stating that it is not [fol. 87] now desirable that its business be continued, which will then wipe out that order, and the trustee has consistently refused to do that.

The Court: That is a peculiar way to get at it. If that had been called to the Court's attention at the first hearing, the Court would have gladly clarified that by saying that it is not to be continued.

Mr. Palmer: I don't know why Mr. Farmer didn't call your attention to it.

The Court: There is no need for the trustee to file a report on that. I will just say, and enter an order, if you want it, that that did not mean and does not now mean that there is to be any business of an original nature carried on by this trustee on behalf of the debtor.

Mr. Palmer: That will dispose of one of Mr. Farmer's motions.

Now, Your Honor, with reference further to the 167 report, it is and has been highly desirable that that report come in as to the questions, and particularly the 169—well, that part may be what the Court says includes this,

in 167(5), a report on the properties, liabilities, and financial conditions of the debtor, the operation of its business, [fol. 88] and the desirability of the continuance thereof. I presume what the Court has said will answer that request of Mr. Farmer as to the report to be made by the trustee as to the desirability of the continuance of the business.

The Court: I am frank to say that I don't understand that motion in the way it is being presented. If I have a misunderstanding of it I would like to be told now. Certainly you, Mr. Palmer, and Mr. Farmer as well, know as well as any of us know that the business of this company has never been carried on.

Mr. Palmer: Yes, sir.

The Court: And that, therefore, the only possible occasion for any such motion as is being made now is the fact that you found some language in the original order which you believe authorizes the business to be carried on, and you now, for the first time, point to that and say, "I want to make a motion for the trustee to come in with a report and say whether that is desirable or necessary." Now, I just don't understand that sort of procedure. The reason I say that is because, here is a matter that was open to all of us for more than six months, and certainly could [fol. 89] have been taken care of in some other way than this.

Mr. Palmer: I think here is the trouble, your Honor, that 167, and the entire Chapter Ten, does not specifically contemplate such an unusual type of company as Fidelity; that the ordinary report under 167(5) is for, say a concern making cotton stockings, and the trustee is to report immediately to the Court whether the company ought to go on and continue to make cotton stockings, or close up, and that report is desired. Because of the peculiar kind of company Fidelity is this language is hard to apply to the specific case. We all know, as the Court has said, that from the 1st of January 1941 no one attempted to sell any Fidelity contract, and the trustee, in taking over, and the Court, in authorizing it, did not contemplate that; but I think what Mr. Farmer has in mind—and I am speaking for him in this motion—is that he wants the trustee to go on record as saying that the business that Fidelity was doing is not a business such as the trustee would advise the Court

ought to be continued in during the course of the trusteeship.

The Court: The Court is not going to require the trustees [fol. 90] to do that, so that motion is overruled now.

Mr. Palmer: All right, sir; that is one of the things Mr. Farmer wanted a decision on.

Mr. Reinhardt: May I interrupt a minute?

Mr. Palmer: Surely.

Mr. Reinhardt: This may be quibbling, but I don't like to let any possibility of misunderstanding go by. This business of Fidelity's is not so peculiar that it is hard to apply Section 167 to it. There have been other companies very similar to Fidelity that have operated under Chapter Ten and within the framework of 167. The part of 167 that requires the trustee to report on the operation of the debtor's business and the desirability of a continuance thereof, looks to the formulation of a plan of reorganization, as is evidenced by the following language, "And any other matter relevant to the procedure or to the formulation of a plan." Now, the kind of report that that contemplates is a report to the Court saying, "Judge, the business of the debtor should or should not be continued during the pendency of the proceeding, and should or should not be continued after the proceeding when the company is reorganized." The whole thing is the basis [fol. 91] on which the structure of the plan is erected, and for that purpose it seems to me that a report by the trustee as to the desirability of a continuation of the debtor's business is something that is called for under the statute.

The Court: I didn't mean to say that it wasn't. I say that I am not going, by special order, to direct this trustee to do anything about that.

Mr. Reinhardt: I wasn't addressing myself to your Honor's remarks, but rather to Mr. Palmer's, so as to avoid any possibility of confusion as to what the statute calls for. I do think the statute calls for that kind of report on the part of the trustee as part of a report as to what kind of plan, if any, might be feasible.

Mr. Palmer: I am glad of Mr. Reinhardt's explanation. I think it is well taken, and I know that that is what Mr. Farmer wanted the Court to order the trustee to do, which the Court has declined to so order.

The next report he wants is the Court to require the trustee to report under Section 169, which provides that "the

trustee shall prepare and file a plan or report of its reasons why a plan cannot be effected, and shall fix a subsequent time for a hearing on such plan or report, and for the con- [fol. 92] sideration of any objections which may be made."

In behalf of that motion and the other part of Mr. Farmer's motions, your Honor, the Court, perhaps not by order, but by dictation into the record, did fix a time in which the desirability of continuing Fidelity should be determined, that is, as a going concern. The Court has indicated that there can be a reorganization without necessarily having Fidelity as a going concern. The trustee, Mr. Farmer feels, should give the Court and contract holders and interested parties under the requirements of Chapter Ten its ideas as to whether Fidelity should be again operated as a going concern or whether it should not be; and Mr. Farmer would like the Court to require, as the Court has already done in the record a number of times, that the trustee do what the Court ordered it to do, file a report.

The Court: Well, the remarks of Mr. Townsend, as attorney for the trustee, have indicated the reasons why the trustee has not gone ahead with that, the chief one being the fact that the state court receivers have been consistently fighting against the administration of the company's affairs in this court; and I am pursuaded by his remarks that the [fol. 93] trustee had good reason for not going ahead any faster than he has, and if the record is in such form that it shows any delinquency on the part of the trustee in failing to file this report, the Court will now extend the time and make it the sixty days from now that Mr. Townsend has said it will take.

. . . . . .

[fol. 94] Mr. T. C. Townsend: Your Honor, I would like to say a word, if Mr. Palmer is through.

[fol. 95] The Court: All right.

Mr. T. C. Townsend: I understood Mr. Palmer to say that the trustee, in all probability, had purposely delayed the proceedings in connection with the filing of the 167 report. This case has already been in the Circuit Court of Appeals on two different phases of it, both times taken there by Mr. Palmer, both times against the trustee. It is there now on the third appeal, and Mr. Palmer has changed his defendant now and proceeds against the debtor and

leaves the trustee clear out of it. I want to say a word or two. We are representing the trustee and we are defending the trustee the best we can. From the beginning of the responsibility cast upon the trustee by the petition filed in this case he has done the best he could to comply with the provisions of Chapter Ten and to function under Chapter Ten, under great difficulties and, may I say, harassment on every hand.

Now, just to demonstrate to your Honor the situation that is here today. Mr. Lauritzen, representing his clients, doesn't want any notice sent out at all to the contract holders. I believe I understand him correctly.

Mr. Lauritzen: No, the notice I was speaking of, Mr. [fol. 96] Townsend, was a notice telling them to file their claims.

Mr. Townsend: All right, he doesn't want a notice sent out asking the contract holders to file their claims; it might embarrass the situation up in Wisconsin if it did that, his relationship to his client or the contract holders. Mr. Eney wants a classification of the creditors forthwith, and so does Farmer—or I will modify the term "forthwith" by saying at as early a day as he can get it he thinks that is the thing to do. Mr. Warner says that if anything is done in this case until the jurisdiction of the Court is settled, the contract holders will suffer. Just exactly what Mr. Palmer wants I must confess that I don't know now and for a long time I have not known.

Mr. Palmer: I will be glad to advise you, Mr. Townsend.

Mr. T. C. Townsend: Well, you have tried that for several months, and, it may be my stupidity, but I am not advised yet.

What the trustee has done is this, your Honor. The trustee complied literally with the report required under 164, and went further than that section provided in furnishing [fol. 97] information. Some of the information asked by motion filed here today is already in the 164 report. Some confusion did arise with reference to 167, but it is not necessary to go into that. It is only necessary to say that the trustee did file a partial report under Section 167, and the trustee is now ready and willing to proceed with all reasonable dispatch to file a further report under Section 167 within the time fixed by the Court.

Now, that is all the trustee can do. If there has been any delay in this matter, if it has been postponed beyond the

time when these gentlemen think these reports ought to be filed, it is not the fault of the trustee. The position taken here today seems to me simply anomalous and remarkable and not understandable to me. There is an appeal pending in the Circuit Court of Appeals, prosecuted by the state court receivers and others. If that appeal is decided adversely to what this Court decided, all these questions we have been talking about here today are settled, and definitely settled. In other words, they are taking the position that this Court has no jurisdiction to do anything, the trustee has no jurisdiction to do anything, never has had [fols. 98-113] and doesn't have now, and "we are going to win this appeal and they won't have in the future"—that is the position they take. On the other hand they do this, they are asking this trustee to proceed to make reports and file them in this Court under a proceedings which these gentlemen say—some of them, at least; I don't say it is all of them—that this Court has no jurisdiction over at all.

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Endorsed on Cover: File No. 46,820. U. S. Circuit Court of Appeals, Fourth Circuit. Term No. 319. Fidelity Assurance Association, a corporation, Debtor, and Central Trust Company, Trustee for Fidelity Assurance Association, Petitioners, vs. Edgar B. Sims, Auditor of the State of West Virginia, and Ex-Officio Insurance Commissioner of the State of West Virginia, et al. Petition for a writ of certiorari and exhibit thereto. Filed August 20, 1942. Term No. 319 O. T. 1942.



FILE COPY

# SUPREME COURT OF THE UNITED STATES

**OCTOBER TERM, 1942**

## No. 319

FIDELITY ASSURANCE ASSOCIATION, A CORPORATION, DEBTOR, AND CENTRAL TRUST COMPANY, TRUSTEE FOR FIDELITY ASSURANCE ASSOCIATION,
*Petitioners,*

*vs.*

EDGAR B. SIMS, AUDITOR OF THE STATE OF WEST VIRGINIA, AND EX-OFFICIO INSURANCE COMMISSIONER OF THE STATE OF WEST VIRGINIA; ROSS B. THOMAS AND H. ISAIAH SMITH, WEST VIRGINIA STATE COURT RECEIVERS; BANKING COMMISSION OF WISCONSIN; CHAS. R. FISCHER, COMMISSIONER OF INSURANCE AND PERMANENT RECEIVER FOR DEBTOR CORPORATION IN AND FOR THE STATE OF IOWA; JOHN B. GONTRUM, INSURANCE COMMISSIONER OF THE STATE OF MARYLAND; DEWEY S. GODFREY, MISSOURI STATE COURT RECEIVER; L. H. BROOKS, TRUSTEE, FREDERIC LEAKE AND A. L. GOLDBERG, JR., TRUSTEE; AND SECURITIES AND EXCHANGE COMMISSION.

# PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT, BRIEF IN SUPPORT THEREOF AND MOTION AS TO THE RECORD.

JAMES R. FLEMING,
HOMER A. HOLT,
*Counsel for Fidelity Assurance Association, Debtor.*

T. C. TOWNSEND,
*Counsel for Central Trust Company, Trustee for Fidelity Assurance Association.*

JOHN V. RAY,
*Of Counsel for Fidelity Assurance Association, Debtor.*

HILLIS TOWNSEND,
JOHN T. KEENAN,
*Of Counsel for Central Trust Company, Trustee for Fidelity Assurance Association.*

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# SUPREME COURT OF THE UNITED STATES

## OCTOBER TERM, 1942

## No. 319

FIDELITY ASSURANCE ASSOCIATION, A CORPORATION, DEBTOR, AND CENTRAL TRUST COMPANY, TRUSTEE FOR FIDELITY ASSURANCE ASSOCIATION,

*Petitioners,*

vs.

EDGAR B. SIMS, AUDITOR OF THE STATE OF WEST VIRGINIA, AND EX-OFFICIO INSURANCE COMMISSIONER OF THE STATE OF WEST VIRGINIA; ROSS B. THOMAS AND H. ISAIAH SMITH, WEST VIRGINIA STATE COURT RECEIVERS; BANKING COMMISSION OF WISCONSIN; CHAS. R. FISCHER, COMMISSIONER OF INSURANCE AND PERMANENT RECEIVER FOR DEBTOR CORPORATION IN AND FOR THE STATE OF IOWA; JOHN B. GONTRUM, INSURANCE COMMISSIONER OF THE STATE OF MARYLAND; DEWEY S. GODFREY, MISSOURI STATE COURT RECEIVER; L. H. BROOKS, TRUSTEE, FREDERIC LEAKE AND A. L. GOLDBERG, JR., TRUSTEE; AND SECURITIES AND EXCHANGE COMMISSION.

## PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT.

*To the Honorable the Chief Justice and the Associate Justices of the Supreme Court of the United States:*

Your petitioners, Fidelity Assurance Association, a corporation, Debtor, and Central Trust Company, Trustee for Fidelity Assurance Association, respectfully pray that a writ of certiorari issue to review a decree of the United

States Circuit Court of Appeals for the Fourth Circuit entered on June 16, 1942, reversing an order of the United States District Court for the Southern District of West Virginia which order had approved the petition of Fidelity Assurance Association for reorganization under Chapter X of the Bankruptcy Act, and remanding the proceeding to the said District Court with directions to dismiss the petition. An order staying the mandate has been entered by the Circuit Court of Appeals (R. 398).

## Opinions Below.

The opinion of the District Court is a part of the record (R. 3-38) and is reported in 42 Fed. Supp. 973. The opinion of the Circuit Court of Appeals is a part of the record (R. 363-388) and has not yet been reported.

## Jurisdiction.

The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code, as amended by the Act of February 13, 1925. (28 U. S. C. A. 347) and Section 24(c) of the Bankruptcy Act (11 U. S. C. A. 47(c)).

The decree of the Circuit Court of Appeals was entered on June 16, 1942, (R. 387) and a petition for rehearing was denied by order entered by said court on July 22, 1942 (R. 397).

## Statutes Involved.

The issues involve the construction and application to the facts of this case of the Bankruptcy Act, particularly Section 4 of Chapter III and Sections 106(3), 144, and 146 of Chapter X, and of the Investment Company Act of 1940, particularly Sections 2(a)(15) and (17), 3(a)(2), 3(c)(3) and (6), 4(1), 28, 52, of Title I (15 U. S. C. A. 80(a)) and Sections 29(a) and (b) of Title I (11 U. S. C. A. 107(f), 72(a)). The most pertinent provisions of these statutes, not set forth in the Argument, are printed herewith as Appendix A. Article 9, Section 7 of Article 3,

Section 5 of Article 2, Section 12 of Article 2, and Section 45 of Article 3 of Chapter 33 of the Code of West Virginia, and Chapter 46 of the Acts of West Virginia of 1941, the most pertinent provisions of which are printed in Appendix A herewith, and statutes of the same general nature of other states, Tit. 53, Sec. 12 Ala. Code; Ch. 66, Sec. 105 Rev. Code Del., 1935; Ch. 121½, Sec. 101-A, Rev. Stats. Ill., 1939; Ch. 392, Iowa Code 1939; Ch. 45, Art. 12 Baldwin's Ind. Statutes; Ch. 17, Art. 10, Sec. 17-1033, Kans. Stats.; Ch. 72-a, Carroll's Ky. Stats. 1936; Art. 48-a, Sec. 218-234 Ann. Code, Md., 1939; Rev. Stats. Mo., 1939; Ch. 20, Sec. 696, Page's Ohio Code, Ann.; Ch. 28, Tit. 7, Purdon's Pa. Stats.; Pt. 1, Tit. 14, Ch. 4, Michie's Tenn. Code 1938; Title 34-a, Ch. 147-a, Va. Code 1936, Ann.; Sec. 216.01 Wis. Stats., some of which are contained in the record (R. 40-59; 75-89; 203-209) are also involved.

## Summary Statement of the Matter Involved.

The material facts are presented in some detail in the opinion of the District Court (R. 3) and in the opinion of the Circuit Court of Appeals (R. 363). Condensed for the purposes of this petition, the facts of the case and the nature of the proceeding are as follows.

### Nature of the Proceeding.

This proceeding arises under Chapter X of the Bankruptcy Act and was instituted by the filing of a voluntary petition for reorganization by Fidelity Assurance Association, hereinafter sometimes referred to as "Fidelity", in the United States District Court for the Southern District of West Virginia on June 6, 1941.

### Organization and Business of Fidelity.

Fidelity was incorporated under the laws of the State of West Virginia, on April 11, 1911, under the name of Fidelity Investment and Loan Association and was authorized

by its charter to buy, sell, and deal in stocks, bonds, and real estate (C. C. A. Opinion, R. 364).

Fidelity's charter was amended in November, 1912, and its name was changed to Fidelity Investment Association. By the amended charter it was authorized to receive payments on annuity contracts in fixed installments or otherwise and to sell certificates, bonds, or other investment securities of any kind on installment or any other plan of payment (C. C. A. Opinion, R. 364). A copy of this charter is, for convenience, printed herewith as Appendix B.

Under these charter powers from November, 1912 until December 31, 1940, Fidelity was engaged in selling its own securities in the form of investment contracts variously known as annuities, income contracts, or, more recently, face-amount installment certificates, and in investing the funds received from the purchaser. This activity brought Fidelity within the scope of Article 9, entitled Annuity Contracts, of Chapter 33, entitled Insurance and Annuity Contracts, of the Code of West Virginia requiring a license from the Auditor of the State of West Virginia, ex-officio Insurance Commissioner, and by the provisions of Section 3 of said Article 9 (Appendix A herewith) the company was required to deposit securities with the State Treasurer as therein provided. Deposits in lesser amounts were also made with the statutory officials of some fourteen other states pursuant to the respective statutes, of the same general character as the West Virginia statute, of those States. Insurance companies are expressly excluded from the provisions of the said Article 9 of Chapter 33 by Section 1 thereof. Fidelity did business in fourteen other states which required no such deposits. A table of the deposits by States, as of the date of the filing of the petition in this proceeding, is found in the Opinion of the Circuit Court of Appeals (R. 366), from which it will be noted that the deposits in West Virginia are substantially in excess of the liabilities to West Virginia creditors.

In the various States the activities of Fidelity were regulated by various officials or departments: in some, the securities department; in some, the banking department; and, in others, the insurance department (R. 330).

While the various types of investment contracts sold by Fidelity differ in some respects, they are all alike in providing for monthly, semi-annual or annual payments of specified sums, of which a sufficient portion was to be set aside in a reserve fund which was to produce the sum required to pay the purchaser the amount of money agreed upon in the contract. The earlier contracts contained no statement as to the basis of the reserve fund. Of the later contracts, some provided for reserves on a 4½% basis and some on a 4% basis. All provided that the reserve fund so set aside should "be invested in approved securities and deposited in trust as required by the laws of the State of West Virginia" (R. 6-7). In each of the contracts there was a provision whereby, with slight variation in language as to each particular class or series of contracts, Fidelity agreed to create and maintain a reserve fund for such particular class or series from payments made on contracts of that particular class or series, which reserve fund was to be used for the discharge of its liabilities on that particular class or series of contracts; and on its books Fidelity kept these various series funds separate and distinct (R. 9). Some of these series funds, the later and larger ones, are solvent. As a whole Fidelity is about 90% solvent (R. 30-31). It has approximately 88,000 contract holders, whose individual claims are relatively small (R. 366).

About 1934 Fidelity issued a contract known as the "Income Reserve Contract Series B", commonly referred to as the "Series B Contract", the sale of which from that time on until December 31, 1940, constituted the major portion of its business. The Series B Contracts contained an optional provision, "Section 6", under the terms of which Fidelity had arranged with an insurance company

for life insurance under the group and/or individual legal reserve life insurance policy covering the original registered holder of the contract, provided he be in good health and be accepted by the insurance company, the said life insurance policy providing that upon the death of the registered holder the insurance company would pay to Fidelity the amount required by Fidelity to declare the contract fully paid. This Series B Contract, when the said insurance feature option was exercised, called for the payment of larger periodic installments. Fidelity arranged with the Lincoln National Life Insurance Company to issue the said insurance policies (R. 6; 368; 357-361).

In December, 1938, the Securities and Exchange Commission filed a bill for injunction against Fidelity in the District Court of the United States for the Eastern District of Michigan alleging that Fidelity was engaged in acts and practices in the sale of its securities which constituted violations of the provisions of the Securities Act of 1933, and in that cause a consent decree was entered, among other things, enjoining Fidelity from failing to meet the deposit requirements of the several states. In the same month a suit for the appointment of receivers was brought by certain contract holders of Fidelity in the United States District Court for the Northern District of West Virginia based on the facts developed in the suit in Michigan; but the bill was dismissed by the District Court for the reason that insolvency was not established, and its action was affirmed by the Circuit Court of Appeals (R. 369).

### The Investment Company Act of 1940.

Congress enacted the Investment Company Act of 1940, effective as to face-amount certificate companies on January 1, 1941 (54 Stat. 789, 11 U. S. C. A. 80a-52) (R. 366), wherein Congress found that investment companies issuing face-amount installment certificates were affected "with a

national public interest" (R. 366) and enacted regulations to govern the sale of face-amount certificates, with which it was immediately apparent that Fidelity could not comply (R. 367).

### Attempted Extra Judicial Reorganization.

In a futile effort to meet the situation, on December 31, 1940, Fidelity's corporate charter was amended, and its objects and powers were stated to be, "to issue insurance upon the lives of persons and every insurance appertaining thereto and connected therewith, and to grant, purchase and dispose of annuities", and its name was changed to Fidelity Assurance Association (R. 367). Fidelity had not previously had charter powers to issue contracts of insurance.

Under the West Virginia statutes (Code 33-9-1 and 33-2-12, Appendix A herewith) Fidelity's license, under said Article 9, to issue face-amount installment certificates would not expire until April 1, 1941. The Auditor of West Virginia and ex-officio Insurance Commissioner issued Fidelity a license as an insurance company for the period from January 1, 1941, to April 1, 1941, but with the requirement on the part of the Auditor and the agreement on the part of Fidelity that no insurance would be sold and no new annuity contracts would be sold (R. 370). Except as it may be contended that the sending out of certain riders, hereafter mentioned under the subtitle "Proceedings in the Circuit Court of Appeals", to be attached to certain Series B Contracts, containing Section 6, already in existence, were in violation of the agreement, Fidelity observed the agreement and sold no insurance contracts, sold no new annuity contracts, did no business by virtue of this license, and no changes were made in the books of Fidelity, no transfers were made and no surplus was set up (R. 357).

## State Suits.

Fidelity made application for a license as an insurance company for the year commencing April 1, 1941, but the Auditor of West Virginia withheld the license applied for and on April 4, 1941, directed Fidelity to discontinue business. On April 11, 1941, the Auditor, pursuant to Chapter 33, Article 2, Section 5 of the West Virginia Code, with a view to rehabilitation (R. 252-253), filed a bill in the Circuit Court of Kanawha County to take possession of the assets of Fidelity, and, without objection by Fidelity, receivers were appointed by said court. The Auditor of West Virginia notified corresponding officials in the other states in which Fidelity was doing business and corresponding proceedings were promptly instituted in eleven other states (R. 370-371).

## Proceedings in the District Court.

On June 6, 1941, Fidelity filed its petition in the United States District Court for the Southern District of West Virginia alleging insolvency and praying for reorganization under the provisions of Chapter X of the Bankruptcy Act. On the same day, by ex parte order, the petition was approved and your petitioner, Central Trust Company, was appointed trustee. On June 10, 1941, the District Court directed the various state officials and court receivers to deliver to the trustee all property of the debtor in their hands. On August 9, 1941, while the plenary hearing was in progress and after certain answers and motions of intervenors had been filed, the District Court modified the orders of June 6 and June 10, 1941, requiring the state officials and receivers to turn over to the trustee the assets of the debtor by realizing the turn-over requirements but enjoining state officials and receivers from disposing of such assets (R. 319-334). The West Virginia receivers, under protest, and the Ohio receiver, without protest,

turned over to the trustee the property of the debtor in their custody, while the other state officials and receivers generally retained possession of the deposits in their custody (R. 371).

The Auditor of West Virginia, the receivers appointed in the state court proceeding in West Virginia, officials of other states, receivers appointed by other state courts, and others were permitted to intervene and file answers and motions controverting the allegations of the petition and denying the jurisdiction of the District Court for various reasons, among others, that Fidelity was an insurance company and not subject to the provisions of Chapter X of the Bankruptcy Act, and that the petition was not filed in good faith; and the intervenors moved that the petition be dismissed and the turn-over orders be vacated (R. 3-4; 16-17).

A protracted plenary hearing was had in the District Court after which the District Court found that Fidelity was not an insurance corporation, that the petition was filed in good faith, that the principal assets of Fidelity had been in the Southern District of West Virginia during the six months next preceding the filing of the petition, and that the filing of the petition, though not properly authorized originally, had been ratified by proper corporate action; and the District Court, by decree of January 5, 1942, approved the petition (R. 18-40).

During the hearing, many witnesses testified that Fidelity could and should be reorganized (R. 265-291). Some memoranda looking toward the formulation of plans were presented (R. 383), but no definite plan was acted upon by the District Court.

### Proceedings in the Circuit Court of Appeals.

The respondents, other than the Securities and Exchange Commission, appealed from the decree of the District Court to the Circuit Court of Appeals for the Fourth Circuit. The

respondent, Edgar B. Sims, Auditor and ex-officio Insurance Commissioner of West Virginia, filed in the Circuit Court of Appeals a petition for the remand of the case to the District Court and, for the first time, by said petition for remand, introduced into the record a showing that on December 31, 1940, Fidelity had sent out to the holders of Series B Contracts containing Section 6 a letter and certain riders in duplicate, one to be signed and returned to Fidelity and the other to be attached to the contract, by which Fidelity would assume the insurance obligations of such Series B Contracts (R. 339; 341; 342), and in the hearing in the Circuit Court of Appeals it was stipulated that 9,802 of these riders had been signed by the contract holders and returned to Fidelity (R. 361). Fidelity did not in fact assume such insurance obligations for the reason that Fidelity was never authorized by the Auditor of West Virginia to engage in the insurance business (R. 356), and the insurance obligations continued to be carried by the Lincoln National Life Insurance Company as before (R. 357).

The Circuit Court of Appeals found that Fidelity was an insurance company, not eligible for reorganization under Chapter X of the Bankruptcy Act, and that the petition had not been filed in good faith, apparently on the grounds that it was unreasonable to expect that any plan of reorganization could be effected (Sec. 146(3)) and that the interests of creditors would be best subserved in the prior proceedings pending in the state courts (Sec. 146(4)), reversed the judgment of the District Court and remanded the cause with instructions to the District Court to dismiss the petition (R. 372-387).

The decree of the Circuit Court of Appeals reversing the decree of the District Court and remanding the cause with instructions to dismiss, was entered on the 16th day

of June, 1942 (R. 387). The debtor, on the 13th day of July, 1942, presented its petition for a rehearing (R. 389) to the Circuit Court of Appeals, which petition was denied by order of July 22, 1942 (R. 397).

Upon application for a stay of the mandate, by assent of counsel, the Circuit Court of Appeals entered an order on July 22, 1942, staying the mandate upon the condition that this petition for certiorari be presented to this Court within thirty days, and modified the order of the District Court of August 9, 1941, so as to permit the various state officials and receivers to sell assets in their custody for the purpose of conserving the estate (R. 398). Learning that some of the respondents considered the modification of the order of August 9, 1941, by the order of July 22, 1942, as a license to sell the assets in their custody for liquidation, your petitioners, on August 7, 1942, filed a motion in the Circuit Court of Appeals for modification of the amendatory order of July 22, 1942, so as to make it clear that the consent to the sale or exchange of assets was for conservation only and not for liquidation (R. 401). The necessity of sending the record to this Court in time to permit the presentation of this petition within thirty days from July 22, 1942, prevented an opportunity for a ruling on said motion by the Circuit Court of Appeals, but, if your petitioners are informed that in disregard of the purposes and intent of the modification order of July 22, 1942, and pending action upon the motion for clarification of August 7, 1942, any of the respondents contemplate selling the assets in their custody for liquidation, these petitioners will ask for a hearing upon said motion.

## Questions Presented.

(1) Is Fidelity Assurance Association an insurance corporation within the Bankruptcy Act and particularly within Chapter X thereof?

(a) Has not Congress by the Investment Company Act of 1940 definitely classified face-amount certificate companies, such as Fidelity (and, we may say, Fidelity itself (R. 366)) as investment companies subject to bankruptcy as distinguished from insurance companies excluded from bankruptcy?

(b) Under the Bankruptcy Act, and particularly Chapter X thereof, is the character of a corporation to be determined by its charter powers, or by the character of its business activities and its obligations sought to be reorganized?

(c) Under the Bankruptcy Act, and particularly Chapter X thereof, if a corporation is to be classified as within or without the Bankruptcy Act by its charter powers, is it to be classified by the charter powers under which it has done business, acquired and managed its assets, and incurred its obligations, or is it to be classified by recently acquired charter powers, sought for the purpose of extra judicial reorganization, under which it has done no business other than such acts as have merely carried on for a short time its previously established business, and has done no other acts except such as were incident to an abortive attempt to reorganize extra judicially?

(2) Does it appear from the record that the petition of the debtor has not been filed in good faith, as the term is employed in Section 146 of Chapter X of the Bankruptcy Act?

(a) In advance of the presentation of a plan of reorganization, the presentation of which has been rendered impracticable by litigation in which the basic jurisdiction of the District Court has been questioned, and in advance of consideration of any plan by the District Court, can it be said that the record shows that "it is unreasonable to expect that a plan of reorganization can be effected"?

(b) Does it appear from the record that the several twelve prior proceedings in the courts of twelve different States (R. 370-371), with their respective territorial limitations, will subserve the interests of the creditors better than a single proceeding, in the United States District Court for the Southern District of West Virginia, in which the court would have jurisdiction over the assets of Fidelity wherever they may be located? (Bankruptcy Act, Sec. 111; 11 U. S. C. A. 511.)

(c) Does it appear from the record that these several State court proceedings will afford the creditors the safeguards provided by the Investment Company Act of 1940 and Chapter X of the Bankruptcy Act, in a subject matter which the Congress has expressly found to be affected with a national public interest? (Investment Company Act of 1940, Title I, Sec. 1(a), 29(b).)

(3) Should not this Court, upon the record, reverse the decree of the Circuit Court of Appeals and affirm the decree of the District Court approving the petition?

**Reasons Relied On for the Allowance of the Writ.**

(1) The Circuit Court of Appeals classified Fidelity as an insurance company contrary to the unmistakable classification of corporations of the type of Fidelity by Congress as face-amount certificate investment companies, and not as insurance companies, under the Investment Company Act of 1940 (Argument, p. 19 hereof).

(2) The Circuit Court of Appeals has decided an important question of federal law arising in the administration of the Bankruptcy Act, and particularly Chapter X thereof, which has not been, but should be, settled by this Court, namely, what is an insurance corporation within the meaning of the Bankruptcy Act. Indeed, there is no decision of this Court laying down the principles by which corpora-

tions excluded from bankruptcy, expressly or by implication, are to be classified (Argument, p. 24 hereof).

(3) The Circuit Court of Appeals has decided the federal question of what is an insurance corporation within the meaning of the Bankruptcy Act in a way that is probably in conflict with applicable decisions of this Court. There is no decision of this Court deciding what is an insurance corporation, or laying down the principles of classification, within the meaning and purposes of the Bankruptcy Act; but in other situations and applications this Court has laid down the principle of classification by corporate activities. If this principle of classification be applicable under the Bankruptcy Act, then the decision of the Circuit Court of Appeals is in conflict therewith (*Bowers* v. *Lawyers Mortgage Company* (1931), 285 U. S. 182; *U. S.* v. *Home Title Insurance Co.* (1931), 285 U. S. 191), (Argument, p. 26 hereof).

(4) There is no decision of the Supreme Court of Appeals of West Virginia classifying Fidelity, or other corporations engaged in like activities, as or as not an insurance company, but it is believed that the statutes of West Virginia unmistakably classify Fidelity as a corporation other than an insurance corporation, and the Circuit Court of Appeals, in attempting to apply the state classification test to Fidelity, has classified Fidelity as an insurance corporation contrary to the plain West Virginia statutory classification as a corporation other than an insurance corporation (Argument, p. 28 hereof).

(5) In deciding that Fidelity is an insurance corporation, the Circuit Court of Appeals has laid down principles of classification which conflict with the principles of classification laid down by other Circuit Courts of Appeals in considering what corporations, including insurance corpora-

tions, are excluded from the provisions of the Bankruptcy Act.

Since the amendment of the Bankruptcy Act in 1910 and in 1938, some Circuit Courts of Appeals have adopted what is called the "state classification" test or principle, but other Circuit Courts of Appeals seem to apply the "corporate activities" test or principle, and some decisions which purport to apply the "State classification" test or principle lean heavily upon the corporate activities factor (Argument, p. 29 hereof).

(6) If the meaning of the decision of the Circuit Court of Appeals that it is unreasonable to expect that a plan of reorganization can be effected is based upon the apparent holding that there can be no reorganization within the meaning of Chapter X of the Bankruptcy Act unless it be the rehabilitation of Fidelity as a going concern, and we believe that is the proper interpretation of the opinion of the Circuit Court of Appeals, then the decision is in conflict with the decisions of other Circuit Courts of Appeals (Argument, p. 38 hereof).

(7) An inquiry into what facts and circumstances lead to a conclusion that the interests of creditors will be best subserved by the prior State court proceedings presents a Federal question for the determination of which the principles have not been, but should be, settled by this Court (Argument, p. 41, hereof).

WHEREFORE your petitioners respectfully pray that a writ of certiorari be issued out of and under the seal of this Honorable Court, directed to the Circuit Court of Appeals for the Fourth Circuit, commanding that court to certify and send to this Court for its review and determination, on a day certain to be therein named, a full and complete transcript of the record and all of the proceedings

in the case numbered on its docket No. 4923 and entitled "Edgar B. Sims, Auditor of the State of West Virginia, and Ex-Officio Insurance Commissioner of the State of West Virginia; Ross B. Thomas and H. Isaiah Smith, West Virginia State Court Receivers; Banking Commission of Wisconsin; Chas. R. Fischer, Commissioner of Insurance and Permanent Receiver for debtor corporation in and for the State of Iowa; John B. Gontrum, Insurance Commissioner of the State of Maryland; Dewey S. Godfrey, Missouri State Court Receiver; and L. H. Brooks, Trustee, Frederic Leake and A. L. Goldberg, Jr., Trustee, Appellants, versus Fidelity Assurance Association, a corporation, Debtor, Appellee", and that the judgment of the Circuit Court of Appeals for the Fourth Circuit may be reversed and the decision of the District Court affirmed and that your petitioners may have such other and further relief in the premises as to this Court may seem proper.

JAMES R. FLEMING,
HOMER A. HOLT,
*Attorneys for Fidelity Assurance Association, Debtor.*

THOMAS C. TOWNSEND,
*Attorney for Central Trust Company, Trustee for Fidelity Assurance Association.*

JOHN V. RAY,
*Of Counsel for Fidelity Assurance Association, Debtor.*

HILLIS TOWNSEND,
JOHN T. KEENAN,
*Of Counsel for Central Trust Company, Trustee for Fidelity Assurance Association.*

## BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

A statement of the case has been given in the petition and, to avoid duplication, is not repeated.

### Summary of Argument.

I.

Congress, by the Investment Company Act of 1940, has classified Fidelity as a corporation other than an insurance corporation.

II.

The Circuit Court of Appeals has decided an important question of Federal law arising in the administration of the Bankruptcy Act, and particularly Chapter X thereof, which has not been, but should be, settled by this Court; namely, what is an insurance corporation within the meaning of the Bankruptcy Act.

III.

The Circuit Court of Appeals has decided the Federal question of what is an insurance corporation within the Bankruptcy Act in a way that is probably in conflict with applicable decisions of this Court. There is no decision of this Court deciding what is an insurance corporation, or laying down the principles of classification within the meaning and purposes of the Bankruptcy Act, but in other situations and applications this Court has laid down the principle of classification by corporate activities. If this principle of classification be applicable under the Bankruptcy Act, then the decision of the Circuit Court of Appeals is in conflict therewith.

IV.

There is no decision of the Supreme Court of Appeals of West Virginia classifying Fidelity, or other corporations engaged in like activities, as or as not an insurance company, but it is believed that the statutes of West Virginia unmistakably classify Fidelity as a corporation other than an insurance corporation, and the Circuit Court of Appeals has classified Fidelity as an insurance corporation contrary to the plain West Virginia statutory classification.

V.

In deciding that Fidelity is an insurance corporation the Circuit Court of Appeals has laid down principles of classification which conflict with the principles of classification laid down by other circuit courts of appeals in considering what corporations, including insurance corporations, are excluded from the provisions of the Bankruptcy Act.

VI.

If the meaning of the decision of the Circuit Court of Appeals that it is unreasonable to expect that a plan of reorganization can be effected is based upon the apparent holding that there can be no reorganization within the meaning of Chapter X of the Bankruptcy Act unless it be the rehabilitation of Fidelity as a going concern, and we believe that is the proper interpretation of the opinion of the Circuit Court of Appeals, then the decision is in conflict with the decisions of other circuit courts of appeals.

VII.

An inquiry into what facts and circumstances lead to a conclusion that the interests of creditors will be best subserved by the prior State court proceedings presents a

Federal question for the determination of which principles have not been, but should be, settled by this Court.

## ARGUMENT.

Except for specific references otherwise, we shall discuss Fidelity, as to both corporate powers and business activities, from the point of view of its business from 1912 to December 31, 1940, that being the period of its actively engaging in the business involved, confident that its character was not, in fact, changed by its efforts at extra judicial reorganization between December 31, 1940, and June 6, 1941.

### I.

### Congress Has Classified Companies Such as Fidelity as Face-amount Certificate Investment Companies Rather Than as Insurance Companies.

If the Congress has classified corporations of the type of Fidelity as companies other than insurance, rather than as insurance companies, then the judicial classification of Fidelity as an insurance company by the Circuit Court of Appeals is clearly erroneous.

Unquestionably, Congress has the power to classify corporations for the purpose of Federal legislation, and when Congress has made such classification, in the absence of constitutional objections, none of which is suggested by the record in this case, the courts should follow the classification made by the Congress. (*In re Supreme Lodge of Masons*, 286 F. 180, 183; *In re Wisconsin Cooperative Milk Pool*, 119 F. (2d) 999, 1002, Cert. Den. 314 U. S. 655.) *Kansas* v. *Hayes*, 62 F. (2d) 597, 599.

A reading of the Investment Company Act of 1940 (Aug. 22, 1940, Chap. 686, Title I, 15 U. S. C. A., 80a, 1-52), we believe, shows not only that Congress has classified

Fidelity as a face-amount certificate company under the Investment Company Act and as a corporation other than an insurance corporation, but that this Congressional classification was made for the purposes, among others, of the Bankruptcy Act (Aug. 22, 1940, Chapt. 686, Sec. 29 (a), (b); 11 U. S. C. A., 72 (a), 107 (f)).

Congress has defined a "face-amount certificate" as follows:

> "(a) When used in this subchapter and sections 72 (a), last sentence, and 107 (f) of Title 11, unless the context otherwise requires——
>
> " • • •
>
> "(15) 'Face-amount certificate' means any certificate, investment contract, or other security which represents an obligation on the part of its issuer to pay a stated or determinable sum or sums at a fixed or determinable date or dates more than twenty-four months after the date of issuance, in consideration of the payment of periodic installments of a stated or determinable amount (which security shall be known as a face-amount certificate of the 'installment type'); or any security which represents a similar obligation on the part of a face-amount certificate company, the consideration for which is the payment of a single lump sum (which security shall be known as a 'fully paid' face-amount certificate)."
>
> 15 U. S. C. A., § 80a-2 (a) (15).

Congress has defined an "investment company" as including the business of issuing face-amount certificates:

> "(a) When used in this subchapter and sections 72(a), last sentence, and 107(f) of Title 11, 'investment company' means any issuer which——
>
> " • • •
>
> "(2) is engaged or proposes to engage in the business of issuing face-amount certificates of the install-

ment type, or has been engaged in such business and has any such certificate outstanding; or

"• • •"

15 U. S. C. A. § 80a-3 (a)(2).

In fact, the "face-amount certificate company" is one of the three principal classes of investment companies:

> "For the purposes of this subchapter and sections 72(a), last sentence, and 107(f) of Title 11, investment companies are divided into three principal classes, defined as follows:
>
> "(1) 'Face-amount certificate company' means an investment company which is engaged or proposes to engage in the business of issuing face-amount certificates of the installment type, or which has been engaged in such business and has any such certificate outstanding.
>
> "• • •"

15 U. S. C. A. § 80a-4 (1).

Congress has gone further. The Investment Company Act of 1940 expressly amended certain sections of the Bankruptcy Act in a way to make specific application of the Bankruptcy Act to face-amount certificate companies. It prescribed a particular method for the selection of the trustee in bankruptcy for face-amount certificate companies:

> "• • • If the bankrupt is a face-amount certificate company, as defined in section 80a-4 of Title 15, the court alone shall make the appointment; but the court shall not make such appointment without first notifying the Securities and Exchange Commission and giving it an opportunity to be heard."

Aug. 22, 1940, c. 686, Title I, § 29(b); 11 U. S. C. A., § 72a.

The Investment Company Act particularly amends the Bankruptcy Act with respect to deposits or transfers of securities by face-amount certificate companies (Aug. 22, 1940, c. 686, Title I, § 29(a); 11 U. S. C. A., § 107f (1) (a); (Appendix A), manifesting an unmistakable Congressional intent that face-amount certificate companies be within the provisions of the Bankruptcy Act.

In fact, counsel for the West Virginia respondents, in giving a summary of Federal legislation affecting Fidelity, say that Congress provided in § 29 of the Investment Company Act for "bankruptcy of face-amount certificate companies" (R. 162), we may add, anticipating the difficulties which such companies would experience when the Investment Company Act should become effective.

The Investment Company Act does not stop with these definitions of face-amount certificate companies but, for purposes of contrasting insurance companies with face-amount certificate companies and other investment companies and of exempting insurance companies from the provisions of the Investment Company Act and of bringing face-amount certificate companies within the provisions of the Investment Company Act and also within the provisions of the Bankruptcy Act, defines an insurance company as follows:

> "(a) When used in this subchapter and sections 72 (a), last sentence, and 107 (f) of Title 11, unless the context otherwise requires—
>
> "• • •
>
> "(17) 'Insurance company' means a company which is organized as an insurance company, whose primary and predominant business activity is the writing of insurance or the reinsuring of risks underwritten by insurance companies, and which is subject to supervision by the insurance commissioner or a similar official or agency of a State; or any receiver or similar

official or any liquidating agent for such a company, in his capacity as such."

15 U. S. C. A., § 80a-2 (a) (17).

Under this definition of an insurance company, even if the sending out by Fidelity of the riders to the Series B Contracts having the § 6 provisions were the making of insurance contracts as was concluded by the Circuit Court of Appeals, which we do not admit, yet, Fidelity would not be within the definition of an insurance company for the reason that, admittedly, the insurance features of the Series B Contracts were but incidental to the primary and predominant business of issuing face-amount certificate contracts.

The Investment Company Act (15 U. S. C. A., 80a-3 (c) (3)), excludes an insurance company from the definition of an investment company, but face-amount certificate companies not only are not so excluded but are expressly defined as investment companies and as one of the three principal divisions thereof (15 U. S. C. A. 80a 3(a) (2), 4 (1)).

Section 3 of the Investment Company Act (15 U. S. C. A., 80a-3 (c) (6)) shows that the issuing of face-amount certificates is one of the principal earmarks of an investment company.

In this particular case, Fidelity is not exempted from the provisions of the Investment Company Act or of the Bankrutpcy Act by Section 6 of the Investment Company Act (15 U. S. C. A., 80a-6 (a) (2)) for the reason there was no proceeding pending in a court of the United States or of a State in which a receiver was appointed for Fidelity, prior to the effective date of said Investment Company Act, which was, as to face-amount certificate companies, January 1, 1941 (Aug. 22, 1940, c. 686, Title I, § 53, 15

U. S. C. A., § 80a-52). The State court proceedings were not instituted until April 11, 1941 (R. 12).

For the purposes of discussion of some of the points hereinafter, it is significant to observe that by the very definition of an insurance company in the Investment Company Act (15 U. S. C. A., 80a-2 (a) (17)), the classification of a corporation as an insurance company, is made dependent upon the company's "primary and predominant business activity", which, in order that the company be so classified, must be "the writing of insurance or the reinsuring of risks underwritten by insurance companies, * * *", thus, by clear implication, excluding as tests or principles of classification the mere charter powers, or the nature or source of the charter of the corporation, even though to be so classified the corporation must be "organized as an insurance company". We do not mean to suggest that these factors might not, in proper cases, have some significance.

We earnestly submit that Congress has classified Fidelity as a face-amount certificate investment company and has, for the purposes of the classification, including the purposes of bankruptcy, excluded Fidelity from classification as an insurance company; and that any judicial consideration of the classification of Fidelity, beyond reference to and analysis of the Investment Company Act of 1940, is quite afield the scope of proper judicial inquiry.

## II.

### A Federal Question Which Has Not Been, but Should Be, Settled by This Court.

In the administration of a Federal statute the meaning of the language used, in this case the meaning of the words "insurance corporation", whether the meaning be ascer-

tained by Congressional classification, by a Congressional intent that the classification be determined by State laws, or otherwise, presents a Federal question. So far as this case is concerned, we are confident that the Investment Company Act and the amendments made to the Bankruptcy Act thereby make the question rather academic. Yet, it is a Federal question which this Court has not settled, but, we believe, should settle.

Considering the variety of powers that are contained in the charters of the many corporations organized under the varying laws of the several States, the multiplicity of activities frequently engaged in by a single corporation, the differences in the laws of the several States relative to the issuance of corporate charters, together with the expanding field of Federal legislation, it is inevitable that questions of this general type will recur frequently. We believe that the principles of classification of corporations within the purposes of the Bankruptcy Act and especially the reorganization provisions thereof, Chapter X, should be settled by this Court.

This general question has arisen frequently in the circuit courts of appeals and there seems to be appreciable confusion in determining the principles by which corporations should be classified, and even more confusion in applying the principles selected to the facts of the several cases. Some of the circuit courts of appeals, including that of the Fourth Circuit in the case at bar, have disclaimed the applicability of the principles for the classification of corporations laid down by this Court in administering tax statutes.

These considerations suggest the desirability of clarifying this question, particularly as it arises under the Bankruptcy Act and under the Investment Company Act of 1940.

## III.

### Decision of Circuit Court of Appeals, Fourth Circuit, Probably in Conflict with Applicable Decisions of This Court.

If, in order that it may be said that the decision of a circuit court of appeals is in conflict with an applicable decision of this Court, it is necessary that the decision of this Court relate to the same laws and the same subject matter as were considered by the circuit court of appeals, then it cannot be said that, with respect to the classifying of Fidelity as an insurance or other company, the decision of the Circuit Court of Appeals is in conflict with any decision of this Court, since there is no such specific decision of this Court.

This Court has decided what is, and what is not, an insurance company under the tax statutes. (*Bowers* v. *Lawyers Mortgage Company*, 285 U. S. 182; *United States* v. *Home Title Insurance Company*, 285 U. S. 191.) The classification in these cases was made by this Court on the basis of the activities of the corporations involved. We have already noted that the definition of an insurance company in the Investment Company Act requires that the classification of the company as, or as not, an insurance company be determined by the primary and predominant business activities of the company; although it is also specifically required that, in order to be an insurance corporation, the corporation be chartered as such.

In the *Bowers* and *Home Title* cases, the corporations involved were incorporated under the insurance laws of New York. Based upon their respective activities, the corporation in the *Bowers* case was held not to be an insurance company, while the corporation in the *Home Title* case was held to be an insurance corporation. In the case at bar Fidelity did not even have insurance charter powers until its charter was amended December 31, 1940, in an effort to effect an extra judicial reorganization.

We fully appreciate that there are differences in the purposes and objectives of the various tax statutes and of the Bankruptcy Act and that it may plausibly be insisted, as has been done (*In re Union Guarantee & Mortgage Company*, 75 F. (2d) 984, 985, Cert. Den. 296 U. S. 594), that the principles of the *Bowers* and *Home Title* cases have no applicability when the interpretation of the Bankruptcy Act is under consideration. We may inquire, however, whether there is any real basis for such distinction. The question arises in each instance in substantially the same way, the application of a Federal statute using the phrase "insurance corporation" but providing no specific definition of the term. There would seem to be no more reason for excluding non-insurance creditors of Fidelity from the benefits of the Bankruptcy Act, even though upon petition of Fidelity itself, merely because Fidelity may have had, for a short while, insurance charter powers which it exercised only slightly, or not at all, than it would be to exclude the government from collecting taxes on certain business activities carried on by a corporation just because the corporation happened to have other charter powers, not so taxed, or engaged in the taxable business activities *ultra vires*.

We, therefore, believe that the corporate activities afford a sound and applicable basis for classifying corporations in bankruptcy, as well as in tax matters, and that mere incidental activities should be no more controlling of major activities in bankruptcy than in taxation, and that the *Bowers* and *Home Title* cases establishing the principle of classification by corporate activities are applicable decisions of this Court and that the decision of the Circuit Court of Appeals, Fourth Circuit, is in conflict therewith.

Especially would these principles seem to be applicable in this case where the question is whether Fidelity is an investment company or an insurance company and by the

Investment Company Act, which seeks to make the distinction, the primary and predominant activities of the corporation are in the main made determinative, even though Fidelity may have had, for a short time, an insurance charter under which it did nothing except to try to effect an extra judicial reorganization. In enacting the Investment Company Act of 1940 definition of an insurance company, no doubt the Congress considered and adopted the principles of the decisions of the *Bowers* and *Home Title* cases. The definition adopted would so indicate.

## IV.

### Classification by State of West Virginia.

It is not questioned that from 1912 to December 31, 1940, Fidelity operated under the provisions of Article 9, Chapter 33 of the West Virginia Code (R. 364). Section 1 of said article (Appendix A) expressly provides:

> "* * * Provided, however, That this article shall not be construed as applying to persons, associations or corporations engaged in selling merchandise in installments, *insurance companies*, foreign or domestic, duly authorized to do business in this State, * * *"

If it can be said that the State classification of Fidelity is that Fidelity is an insurance company, then, by the very express terms of the article, enacted for the supervision and regulation of annuity companies, annuity companies are excluded as insurance companies from the operations of the statute, rendering the article, for all practical purposes, nugatory and without subject matter upon which to operate.

Again, the West Virginia statutes under which the State court proceeding was instituted in West Virginia (Code 33-9-10, 33-2-45, Appendix A) provides that the insurance commissioner shall have the same authority in this respect

over annuity corporations as he has over insurance companies. If Fidelity were an insurance company, there would be no reason for the enactment of any statute to make specifically applicable to annuity corporations the statutory provisions already applicable to insurance companies. That activities of Fidelity were under the supervision of the insurance commissioner does not make Fidelity an insurance company (*Capital Endowment Company* v. *Kroeger*, C. C. A. 6, 1936, 86 F. (2d) 976. See also *In re Prudence*, 79 F. (2d) 77. Cert. Den. 296 U. S. 646.

In view of these statutes, how can it be said that the State of West Virginia has classified Fidelity as an insurance company? True, it is provided that life insurance companies may issue annuity contracts (West Virginia Code, 33-3-7; Appendix A), but that lacks much of saying that annuity corporations may issue life insurance or that annuity corporations are insurance companies. West Virginia has provided different statutes regulating life insurance (Chapter 33, Article 3) and annuity contracts (Chapter 33, Article 9). (Compare *Gamble* v. *Daniel*, C. C. A. 8, 1930, 39 F. (2d) 447.) Cert. Den. 282 U. S. 848.

We believe that the decision of the Circuit Court of Appeals is in conflict with the plain classification of Fidelity as a corporation other than an insurance company by the State of West Virginia.

## V.

### Conflict with Decisions of Other Circuit Courts of Appeal and Inconclusiveness of Decisions of the Circuit Courts of Appeal.

The problem of classifying corporations as within or without the provisions of the Bankruptcy Act has arisen frequently in the several circuit courts of appeal. With-

out questioning the conclusions reached in the many cases, other than that reached by the Circuit Court of Appeals in the case at bar, we assert that these decisions are replete with conflicts and inconsistencies in their efforts to settle the principles by which corporations for the purposes of bankruptcy are to be classified and in applying the selected principles to the facts of the several cases. In some cases conflicting principles have been applied even in the same decision. The decision of the Circuit Court of Appeals in the case at bar conflicts, in whole or in part, with decisions of other circuit courts of appeal.

Under the Bankruptcy Act of 1898, which provided that "• • • any corporation engaged principally in manufacturing, trading, printing, publishing, mining or mercantile pursuits • • •" was subject to bankruptcy, the business activities of the corporation were looked to and were determinative in deciding whether or not the corporation was subject to the Act. Since the amendments of 1910 and 1938, specifically exempting municipal, railroad, insurance and banking corporations, and building and loan associations, the business activities rule, as such, has been affirmed in some cases (i. e.: *In re Supreme Lodge of the Masons Annuity*, D. C. Ga., 1923, 286 Fed. 180; *In re Wisconsin Cooperative Milk Pool*, C. C. A. 7, 119 F. (2d) 999, Cert. Den. 314 U. S. 658), and the business activities have been leaned upon heavily, we believe the rule applied in fact, in other cases nominally predicating the decision upon the "charter power" or "State classification" rules, as noted hereafter.

Some decisions, noting that these exempted corporations were not defined by the Act, have taken the position that the purpose of the amendment was to eliminate the factual uncertainties incident to a determination of the principal business of a corporation participating in more than one business activity, and to make the exceptions specific of

certain corporations, which, in the absence of Congressional definition, should be selected according to the classifications given them by the States, noting also that the exempted corporations were generally regarded as "affected with a public interest" and regulated by the States, from which it was inferred that the Congress had determined to leave them for State administration as well as regulation. (Typical of these cases is: *In re Union Guarantee & Mortgage Company*, C. C. A. 2, 1935, 75 F. (2d) 984, 985, quoted from at length in the opinion of the Circuit Court of Appeals in the case at bar.)

This is a very plausible theory, not unsupported by some logic, and one which has received rather wide acceptance, at least in lip service, as a "State classification" rule, but one which has failed to eliminate many of the uncertainties attributable to the "corporate activities" rule, and one which we believe, if so far as it is based upon Congressional exclusion because of State supervision, certainly as to face-amount certificate companies, Congress has rejected by the enactment of the Investment Company Act of 1940.

In the State classification decisions sometimes a question arises as to whether the State classification is determined by the charter powers, the laws under which the charter was issued, or the character of the supervisory authority. Where the charter powers are harmonious with the general coverage of the laws under which they were issued and the supervision is by an official whose duties are well catalogued therewith, and the corporate activities are in keeping therewith, the State classification rule naturally works with precision; but, where a real question arises, most of the decisions have found it necessary to fall back upon the "activities" rule in fact, if not in name.

Detailed analysis and comparison of all of the pertinent decisions would unnecessarily extend this discussion. It

is believed that a brief analysis of a few of the decisions will demonstrate the unsettled status of the principles and their applications, as well as the conflict of the decision of the Circuit Court of Appeals in the case at bar with some of the other decisions.

In the Second Circuit, in the case, *In re Union Guarantee & Mortgage Company*, 1935, 75 F. (2d) 984, of the corporation involved, it was said: "It was organized under the Insurance Law of the State of New York * * * and its business was to make loans secured by mortgages on real property which it sold to its customers with a guaranty." Applying the State classification rule, it was held to be excluded from reorganization under Section 77B of the Bankruptcy Act, for the reason that its charter was issued under the insurance law.

In the same circuit, in the case, *In re Prudence Company*, 1935, 79 F. (2d) 77, of the corporation involved, actually engaged in the same business as the corporation involved in the *Union Guarantee & Mortgage Company* case, it was said: "The debtor was incorporated in 1919 under the article of the Banking Law (New York), relating to investment companies. * * * Its business has consisted in making mortgage loans on real estate and selling the mortgages to the public with its guaranty of payment." This corporation was held not to be a banking corporation and to be within the provisions of 77B. It was observed: "* * * it cannot be successfully contended that every corporation which may be formed under the New York Banking Law is a banking corporation * * *," pointing out that the Banking Law was entitled "An Act in relation to banking corporations * * * and corporations under the supervision of the banking department," and that under the various articles of the Banking Law may be formed "banks, trust companies, safe deposit companies,

and investment companies," so, with respect to Fidelity, and the conflict of the decision of the Circuit Court of Appeals, Fourth Circuit, in the case at bar with this decision, even if all of Chapter 33 of the West Virginia Code, entitled "Insurance and Annuity Contracts" were regarded as "insurance laws," and although insurance and annuity corporations are under the supervision of the Insurance Commissioner, it cannot be contended that every corporation which operates under said Chapter 33 is an insurance company with any greater success than it was contended in the *Prudence* case that every corporation operating under the Banking Law of New York was a banking corporation. In Chapter 33 of the West Virginia Code there are different articles dealing with different types of corporations, particularly insurance corporations on one hand and annuity corporations on the other, just as under the New York laws there were different articles dealing with different types of corporations, including banks, trust companies, safe deposit companies, and investment companies; and Article 9 of Chapter 33 of the Code of West Virginia is the article under which annuity companies, defined by Congress as face-amount certificate companies, have operated. But the *Prudence* case goes further, and, turning to activities, said the corporation was not a banking corporation because it never did obtain the power to receive deposits, the criterion of a banking corporation. Again, the corporation was held not to be an insurance company (79 F. (2d) 77, 80), although the guaranteeing of mortgages was recognized as contracts of insurance (*Bowers* v. *Lawyers' Mortgage Co.*, 285 U. S. 182, 189), because the corporation was not chartered under the Insurance Law and its guaranty of mortgages was "but incidental to its mortgage business," with which conflicts again the decision of the Circuit Court of Appeals, Fourth Circuit, in the case at bar, in which, if Fidelity made any

insurance contracts, which we do not admit, they were but incidental to the annuity contract business.

Thus, applying with reasonable consistency in legal principle the State classification test, the Circuit Court of Appeals, Second Circuit, has reached diametrically opposite conclusions with respect to two corporations engaged in what would seem to be almost identical business activities, holding one, Union Guarantee & Mortgage Company, to be excluded from the provisions of the Bankruptcy Act because its charter was issued under the Insurance Laws of New York, and holding the other Prudence Company, not to be so excluded because, although its charter was issued under the general Banking Law of New York, it was not issued under the particular article dealing with banks of deposit, and was, therefore, not a banking corporation within the purposes of the Bankruptcy Act according to such State classification.

In the case of *Empire Title and Guarantee Company* v. *United States*, 1939, 101 F. (2d) 69, the Circuit Court of Appeals for the Second Circuit reviews these two cases.

In the Fifth Circuit, in the case of *Clemons* v. *Liberty Savings & Real Estate Corporation*, 61 F. (2d) 448, the corporation was chartered by the superior court after the petition for incorporation had been amended by making the name "Liberty Savings & Real Estate Corporation" rather than "Liberty Banking & Real Estate Corporation," and granted, in addition to the real estate powers, among others, the powers "* * *; to buy, sell, and deal in stocks, bonds, promissory notes, and all kinds of choses in action; to advance or lend money to its stockholders or other persons, and to adopt a system of loans, advances, terms, and payments in installments in like manner, as to its interest charges and computations as may be done by building and loan associations under the laws of Georgia; to conduct

a savings department for its members and other persons with the right to receive deposits not subject to check, and to pay interest thereon." The questions were whether the corporation was a banking corporation or building and loan association, or neither of them, under the Bankruptcy Act. Charters of banks could be issued only by the Secretary of State, while charters for building and loan associations could be issued by the Superior Court. The court observed: "the status of a corporation is fixed by its charter," and held that the corporation was not a banking corporation, observing, with respect to evidence that the depositors were permitted to make withdrawals from time to time, "* * * If it occasionally engaged in banking transactions, those acts were ultra vires and could not operate to make it a bank within the meaning of the Bankruptcy Law; * * *." The source of the charter appears to have been accepted as the test. Were this test applied consistently, the corporation might have been a building and loan association, but the court, in disposing of this question, turned to the activities and observed: "There is no evidence whatever in the record that would indicate that appellee did the business usually conducted by a building and loan association."

See also *Republic Underwriters* v. *Ford*, 1938, 100 F. (2d) 511, also from the Fifth Circuit.

In the Sixth Circuit, in the case of *Capital Endowment Company* v. *Kroeger*, 1936, 86 F. (2d) 976, the debtor was incorporated under the general provisions of the Ohio corporations statute and authorized to engage in business as a bond investment company, originally subject to the supervision of the deputy inspector of building and loan associations and, later, by statutory revision, to the supervision of the superintendent of insurance. The debtor claimed to have abandoned the bond investment business before the

supervision was transferred to the superintendent of insurance. The superintendent of insurance was empowered by statute to take over and liquidate domestic building and loan associations and prepared to take over two such associations, the assets of which were acquired by the debtor before the insurance commissioner could take effective steps therefor. Actions were instituted to avoid the transfers of the building and loan assets to the debtor. Disposing of the contention that debtor was an insurance corporation, the court, citing *In re Prudence, supra,* held:

> "* * * But the present debtor is not an insurance corporation. It was organized under the general incorporation law of Ohio, and while it later qualified as a bond investment company, it is not denied that it abandoned this field prior to the filing of its petition. The mere fact that bond investment companies were placed under the supervision of the Superintendent of Insurance could neither enlarge their powers nor alter their business * * *." 86 F. (2d) 976, 979.

It was also held that the debtor was not a building and loan association since it had been deprived of the building and loan assets. No more, in the case at bar, should Fidelity be considered to be an insurance company merely because it is subject to the supervision of the West Virginia State Auditor, ex officio Insurance Commissioner.

For the Sixth Circuit, see also *In re Roumanian Workers Association of America*, 1940, 108 F. (2d) 782, where the activities rule seems clearly to have been applied in holding that the debtor, chartered as a non-profit corporation, was a "moneyed, business or commercial corporation."

In the Eighth Circuit, in the case of *Gamble* v. *Daniel*, 1930, 39 F. (2d) 447, Cert. Den. 282 U. S. 848, the corporation involved, Peters Trust Company, was incorporated under the laws of Nebraska. It was held that the company was a trust company under Article 19 of Title V of the

Nebraska Laws, rather than a banking company under Article 17 of said title, and not a banking corporation within the Bankruptcy Act, "• • • although section 8068 gives trust companies most, if not all, of the powers usually exercised by a bank or enumerated in sections 7983 and 7985 of article 17, *except receiving deposits*, section 8068 forbids any trust company 'to conduct the business of banking, as defined in Title V, Article XVII' • • • and section 7985 makes it unlawful (with exceptions not here material) to transact a banking business except by those complying with article 17."

It was contended that the trust company was a banking corporation if it were authorized to engage in any one of the classes of activities within the statutory definition of "business of banking" (39 F. (2d) 447, 451), but such contention was rejected. The decision of the Circuit Court of Appeals, Fourth Circuit, in the case at bar, if not in this respect in conflict with this decision, would have likewise rejected the contention that Fidelity was an insurance company because it sold annuity contracts, which is one of the powers of life insurance companies under the West Virginia statute (West Virginia Code 33-3-7; Appendix A).

Of interest in illustrating decisions in which no real differences between powers and activities were presented are: *Security B. & L. Association* v. *Spurlock*, C. C. A. 9, 1933, 65 F. (2d) 768, Cert. Den. 290 U. S. 678, and *State of Kansas* v. *Hayes*, C. C. A. 10, 1932, 62 F. (2d) 597.

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We believe that the decision of the Circuit Court of Appeals, Fourth Circuit, in the case at bar, conflicts in principle with several of these cases. At least it can be said with assurance that there are many inconsistencies between the case at bar and these cases from other circuits;

there are inconsistencies between the decisions of some of the other circuits and even within the same decisions. It would seem to be highly desirable that this Court resolve these inconsistencies by settling the correct principles of classification of corporations for purposes of administering the Bankruptcy Act, and particularly Chapter X thereof, including a consideration of Congressional classification of face-amount certificate companies by the Investment Company Act of 1940.

## VI.

**Does the record show that it is unreasonable to expect that a plan of reorganization can be effected?**

There is in the record much testimony of qualified witnesses that in their opinions Fidelity can be reorganized (R. 265-291). The respondent Sims, West Virginia State Auditor and ex officio Insurance Commissioner, and the plaintiff in the West Virginia State court proceedings pursuant to which the respondents Smith and Thomas were appointed State Receivers, who had for more than eight years supervised the activities of Fidelity, thought that there could be reorganization (R. 272-273) and brought the proceeding in the State court for purposes of rehabilitation (R. 252, 253). An offer was made by Pell, Limited, a financial concern, for the common stock of Fidel, the New York subsidiary of Fidelity, and interest was expressed in investing additional capital for the purpose of reorganizing Fidelity (R. 291-292). Even now, counsel for the respondents are endeavoring to act in concert voluntarily for the sale of the assets of Fidelity (R. 409-413), recognizing in Fidelity's assets a value which would not survive forced and divergent liquidations.

Such reorganization in the State court could only be by voluntary reorganization since West Virginia has no appli-

cable reorganization statute and does not have the territorial jurisdiction to reach all of the assets of Fidelity.

Fidelity's aggregate assets amounted to, in round figures, $21,100,000.00, or approximately ninety per cent (90%) of its aggregate liabilities, $23,476,000.00 (R. 366). The reserve funds of Income Reserve Contracts Series A, B, C and D are solvent (R. 252). From 1934 until the end of 1940 the Series B Contracts represented a very large part of Fidelity's entire business (R. 368-369).

This factual observation suggests an inquiry into what dispositions or administrations of Fidelity may be within the scope of reorganization wit' in the meaning of the term as used in Chapter X of the Bankruptcy Act.

We believe that an analysis of the opinion of the Circuit Court of Appeals, Fourth Circuit, in this case irresistibly leads to the conclusion that when the Circuit Court of Appeals considered that Fidelity could not be reorganized, the concept of reorganization entertained by the Circuit Court of Appeals was that Fidelity must be rehabilitated as a going concern, carrying on its business in substantially the same manner as that by which it had previously done business.

This concept of reorganization of the Circuit Court of Appeals, Fourth Circuit, as reflected by its opinion in the case at bar, is clearly not in harmony with the concepts entertained by other circuit courts of appeal. Rehabilitation as a going concern is not required. *In re Central Funding Company*, C. C. A. 2, 1935, 75 F. (2d) 256, 259; *In re Mortgage Securities Corporation*, C. C. A. 2, 1935, 75 F. (2d) 261; *Capital Endowment Company* v. *Kroeger*, C. C. A. 6, 1936, 86 F. (2d) 976, 979; *Continental Insurance Company* v. *Louisiana Oil Refining Corporation*, C. C. A. 5, 1937, 89 F. (2d) 333, 336; *R. L. Witters Associates* v. *Ebsary Gypsum Company*, C. C. A. 5, 1938, 93 F. (2d) 746,

748; *In re Porto Rican American Tobacco Company*, C. C. A. 2, 1940, 112 F. (2d) 655, 657.

It is not believed that this case, long drawn out in the consideration of basic jurisdictional questions, had reached the stage of critical examination of plans of reorganization. *Continental Illinois Bank & Trust Company* v. *C. R. I. & P. R. Co.*, 294 U. S. 648, 685; *R. L. Witters* v. *Ebsary Gypsum Company*, 93 F. (2d) 746, 748; *In re Julius Roehrs Company*, C. C. A. 3, 1940, 115 F. (2d) 723, 724.

The trustee should have an opportunity to explore the possibilities of reorganization. *In re Marine Harbor Properties*, C. C. A. 2, 1942, 125 F. (2d) 296, 298, Certiorari granted 86 L. Ed. (Adv.) 729. It is obvious that the extended litigation relating to the basic jurisdiction of the reorganization court in the case at bar has not afforded a foundation upon which could be based any very practicable opportunity for the trustee to make any such exploration thus far.

Can it be said that it is unreasonable to expect that some insurance or investment company can be found to take over or buy the assets of Fidelity under a contract for the benefit of the Fidelity contract holders, to issue them investment certificates or insurance policies, of one or more kinds, of greater value than the dividends to such contract holders through the liquidation of Fidelity would buy? Such an arrangement would afford the contract holders the benefit, in whole or in part, of the original selling costs of insurance policies or investment certificates which are, comparatively speaking, high and which will have been lost to the contract holders of Fidelity unless some plan of reorganization is effected. The purchaser of the assets might give the contract holders an option of taking in cash their determined equities in liquidation or of accepting an insurance policy or an investment contract. A beneficial merger might be worked out with some other investment company or an insurance company. As suggested by the respondent

West Virginia State Auditor (R. 273), the organization of a mutual company to administer Fidelity's assets for the benefit of the contract holders is not beyond the realm of consideration. It should not be unreasonable to expect that at least the solvent funds or series of the Fidelity contracts might be reorganized and the solvent funds or series constitute a very material part of the assets and business of Fidelity (R. 368). These observations are something more than a mere suggestion of remote possibilities. They are suggestions supported by the record and thoughts which should not be relegated to the realm of mere possibilities as distinguished from probabilities until there has been some opportunity to transform them into realities.

But, as a last resort, even a slow, orderly, beneficial liquidation, which we do not believe to be inevitable in this case, is within the scope of reorganization. *In re Central Funding Corporation, supra; In re Mortgage Securities Corporation, supra; R. L. Witters Associates* v. *Ebsary Gypsum Company, supra; In re Porto Rican American Tobacco Company, supra;* Bankruptcy Act, Chapter X, Sec. 216 (10); 11 U. S. C. A. 616 (10).

The District Court had much upon which to base its conclusion that it was not unreasonable to expect that a plan of reorganization could be effected, and its finding in this respect should not have been reversed by the Circuit Court of Appeals. *In re Mount Forest Fur Farms of America,* C. C. A. 6, 1939, 103 F. (2d) 69, 71, Cert. Den. 308 U. S. 583; *In re Equity Company,* 115 F. (2d) 570, 572-3.

## VII.

**Are the interests of creditors best subserved by the prior State proceedings?**

There is not involved here a single proceeding in any State court to consider the affairs of Fidelity, but already twelve separate State proceedings have been instituted

and there is the prospect of not less than three more such proceedings, should this proceeding be dismissed.

It does not appear that in any of the States in which proceedings have been instituted such proceedings have been instituted under reorganization statutes, if there are reorganization statutes in such States. The proceedings in the States in which they have already been instituted would, unless a voluntary reorganization be effected, liquidate the deposits held in the respective States and distribute the proceeds without regard to any relationship between the particular contracts held by the residents of such States to Fidelity's various funds, supporting the various series of contracts, invested by Fidelity in the assets held by the several State authorities. The prevalent theory of the States participating in this case is that the State deposits, except in West Virginia, are for the primary protection of the holders of the contracts sold in the respective States. This theory may, or may not, be sound. It should be judicially determined by a court having jurisdiction of all of the assets and of the persons interested before there is any distribution.

If there be some twelve or fifteen separate State liquidations, many creditors may be deprived of assets in which they are entitled to participate, even before their legal rights to participation are adjudicated. The adjudication of such rights may be in vain if the assets of Fidelity be administered by so many distinct and separate proceedings in as many separate States.

There is a substantial surplus of assets held in Wisconsin over contract liabilities to residents of that State, and small surpluses in Delaware, Iowa, Missouri, and Alabama (R. 366). The assets held in West Virginia exceed by some eight million dollars the liabilities to the residents of West Virginia. (In the table on page 366 of the Record the liabilities attributable to West Virginia include the lia-

bilities to contract holders in all States which require no deposits.) The deposits in West Virginia, pursuant to the West Virginia law, have apparently been made for the benefit of the holders of contracts, wherever they are and wherever they bought their contracts to the extent that the State in which the contract was sold did not require any deposit or required insufficient deposits.

Whether or not, if there should be liquidation, the assets should be distributed according to the States in which they are held and to the contract holders residing therein, or according to the contract series funds for which Fidelity owned and held these assets, will be a real question which can be effectively determined only while the *res* is undistributed.

It may be, by way of illustration, that the interests of the Wisconsin creditors may be best subserved by a one hundred per cent liquidation in Wisconsin. What about the creditors in other States who own contracts of the same series and may be entitled to participate in the same assets from the standpoint of Fidelity's obligations? Were the deposits required in Wisconsin for the purpose of assuring the solvency of Fidelity or for the benefit only of the contract holders resident in Wisconsin? The same inquiry may be made with respect to the other States.

Can it be said that the interests of all the creditors are best subserved by any such program of liquidation by separate States? We believe, rather, that the very purpose of the Investment Company Act and of the amendments thereof to the Bankruptcy Act, was to avoid any such confusion and futility. In order to know that they are availing themselves of all possible remedies for the protection of their interests, is it to the best interests of the creditors of Fidelity that they be required to file claims in the courts of many States? The amounts of the claims of the several creditors of Fidelity are, for the most part, quite small.

We are not to answer or resolve these questions here but they are suggestions demonstrating the necessity of withholding any distribution until they are settled.

The Circuit Court of Appeals seemed to be of opinion that the interests of the creditors would be best subserved because many questions of State law will likely arise and may be better determined by the State courts. But questions under the laws of many other States also will arise in the courts of the several States. It would seem that the courts of one State would be in no better position to determine the laws of other States than is a Federal Court to determine the laws of the several States. Federal Courts have always been required to consider State laws and there is no reason to believe that the United States District Court for the Southern District of West Virginia will not respect the laws of the several States involved when they become of importance in this proceeding.

The Circuit Court of Appeals, in concluding that the interests of creditors would be best subserved in the prior State court proceedings, also grounded its opinion upon the philosophy that " * * * Congress in excepting from the Bankruptcy Act those corporations, such as insurance, railroad and banking corporations, whose business during their active life and whose liquidation in case of insolvency are strictly regulated by State law. * * * " (R. 386) manifested an intent to abandon such corporations, so to speak, because of the allegedly conceded superiority of State supervision in these respects. If such ever were the Congressional policy, and it may have been at some earlier day, that Congressional policy was most certainly changed, in so far as face-amount certificate companies are concerned, by the enactment of the Investment Company Act of 1940 and the amendments thereof to the Bankruptcy Act.

The foregoing thoughts are expressed to suggest an inquiry of what are the considerations for determining when the prior State proceedings best subserve the interests of the creditors. This is an important question, and a Federal question since it arises under a Federal statute, Chapter X of the Bankruptcy Act, and one which this Court has not yet settled. It is presented by two other cases now pending before this Court, *In re Marine Harbor Properties*, C. C. A. 2, 1942, 125 F. (2d) 296, 298, Certiorari granted 86 L. Ed. (Adv.) 729, and *In re Paloma Estates*, C. C. A. 2, 1942, 126 F. (2d) 72, petition for certiorari filed. It is a question which should be settled by this Court and, since in the *Marine Harbor* and *Paloma* cases properties in more than one State are not involved, it is believed that the disposition of those cases will not necessarily determine the principles for consideration of far-flung activities within the territorial jurisdictions of several States, such as is presented by the case at bar. In these circumstances, the observations of United States District Judge Bryant in the *National Surety Company* case with reference to the obvious superior effectiveness of one Federal Court's having full jurisdiction of the subject matter, when compared to diverse actions in different States, is convincing:

> "It is with regret that I refuse to take jurisdiction. I say this because it is apparent that future administration could be more readily carried on under one control than under the limited jurisdiction of several state courts. It seems almost a travesty to have to deny to this company the benefits of sections 77A and 77B of the Bankruptcy Act while its principal subsidiary is being administered thereunder. However, to hold differently would be the taking of powers that Congress did not deem it wise to give." 7 Fed. Supp. 959, 961.

The conditions and considerations in the case at bar are not greatly different from those involved in the *National Surety Company* case, except that in the case at bar Congress has given the powers which were so desired to be exercised by the court in the *National Surety Company* case.

The record does not indicate that the safeguards considered by Judge Frank in his dissenting opinion in the *Marine Harbor Properties* case (125 F. (2d) 296) will be afforded by the State court proceedings considered in the case at bar. Can it be said that the interests of creditors are best subserved in the prior proceedings in the State courts in the absence of such safeguards or their reasonable equivalents.

Unless all hope for any reorganization is actually futile, and we do not believe that it is, if a reorganization, in whole or in part, or even by slow, orderly, beneficial, complete liquidation, which we do not believe to be inevitable, is for the benefit of the creditors, and we believe it is, it would seem that this interest of the creditors not only can best be subserved by the proceeding in the United States District Court for the Southern District of West Virginia, having jurisdiction of the entire subject matter, but that it can be secured only in that and in no other court, of all the courts in which proceedings have thus far been instituted with respect to Fidelity.

The Conclusion of the District Court on this consideration of good faith was not without much reason both in fact and logic, and should not have been reversed by the Circuit Court of Appeals.

## Conclusion.

It is respectfully represented that this is a case in which this Court, in its sound judicial discretion, may appropriately grant the writ of certiorari as prayed, and that

the petition and the brief in support thereof present special and important reasons therefor.

JAMES R. FLEMING,
HOMER A. HOLT,
*Attorneys for Fidelity Assurance Association, Debtor.*

THOMAS C. TOWNSEND,
*Attorney for Central Trust Company, Trustee for Fidelity Assurance Association.*

JOHN V. RAY,
*Of Counsel for Fidelity Assurance Association, Debtor.*
HILLIS TOWNSEND,
JOHN T. KEENAN,
*Of Counsel for Central Trust Company, Trustee for Fidelity Assurance Association.*

## APPENDIX A.

### Federal Statutes.

11 U. S. C. A. 506, Section 106(3) of Bankruptcy Act:

(a) Any person, except a municipal, railroad, insurance or banking corporation or a building and loan association, shall be entitled to the benefits of this Act as a voluntary bankrupt.

(b) Any natural person, except a wage earner or farmer, and any moneyed, business, or commercial corporation, except a building and loan association, a municipal, railroad, insurance, or banking corporation, owing debts to the amount of $1,000 or over, may be adjudged an involuntary bankrupt upon default or an impartial trial and shall be subject to the provisions and entitled to the benefits of this Act. • • •

11 U. S. C. A. 506, Section 106(3) of Bankruptcy Act:

For the purposes of this chapter, unless inconsistent with the context—

(3) "corporations" shall mean a corporation, as defined in this Act, which could be adjudged a bankrupt under this Act, and any railroad corporation excepting a railroad corporation authorized to file a petition under Section 77 of this Act.

11 U. S. C. A. 544, Section 144 of Bankruptcy Act:

If an answer filed by any creditor, indenture trustee, or stockholder shall controvert any of the material allegations of the petition, the judge shall, as soon as may be, determine, without the intervention of a jury, the issues presented by the pleadings and enter an order approving the petition, if satisfied that it complies with the requirements of this chapter and has been filed in good faith and that the material allegations are sustained by the proofs, or dismissing it if not so satisfied.

11 U. S. C. A. 546, Section 146 of Bankruptcy Act:

Without limiting the generality of the meaning of the term "good faith," a petition shall not be deemed filed in good faith if—

(1) * * *
(2) * * *
(3) it is unreasonable to expect that a plan of reorganization can be effected; or
(4) a prior proceeding is pending in any court and it appears that the interests of creditors and stockholders would be best subserved in such prior proceeding.

11 U. S. C. A. 616(10), Section 216(10) of Bankruptcy Act:

A plan of reorganization under this chapter—(10) shall provide adequate means for the execution of the plan, which may include: the retention by the debtor of all or any part of its property; the sale or transfer of all or any part of its property to one or more other corporations theretofore organized or thereafter to be organized; the merger or consolidation of the debtor with one or more other corporations; the sale of all or any part of its property, either subject to or free from any lien, at not less than a fair upset price and the distribution of all or any assets, or the proceeds derived from the sale thereof, among those having an interest therein; the satisfaction or modification of liens; the cancelation or modification of indentures or of other similar instruments; the curing or waiver of defaults; the extension of maturity dates and changes in interest rates and other terms of outstanding securities; the amendment of the charter of the debtor; the issuance of securities of the debtor or such other corporations for cash, for property, in exchange for existing securities, in satisfaction of claims or stock or for other appropriate purposes.

11 U. S. C. A. 107(f):

(1) For the purposes of, and exclusively applicable to, this subdivision (f): (a) "debtor" shall mean a face-

amount certificate company as defined in section 80a-4 of Title 15; (b) "face-amount certificate" shall mean a face-amount certificate as defined in section 80a-2 of Title 15; (c) "depositary" is a person or State agency with whom securities or other property of a debtor is deposited or to whom property of a debtor is transferred, in trust or otherwise, pursuant to the requirements of a State law or an agreement by the debtor providing for the distribution of such property or its proceeds to creditors or security holders of the debtor in the event of the insolvency of the debtor, or under other specified circumstances; (d) "deposit creditor" is a creditor who, under the provisions of a State law or agreement providing for a deposit with or transfer to a depositary, has rights as to the securities or property so deposited or transferred which exceed the rights of a general creditor; and (e) "State agency" is an official or agency of a State designated to act as depositary or to distribute property or the proceeds of property held by a depositary.

(2) Every deposit or transfer of securities or other property made by or on behalf of a debtor with or to any depositary for the benefit or protection of or to secure the holder of any security sold by or on behalf of the debtor on or after January 1, 1941, shall be voidable as against the trustee of such debtor if the property of the estate is insufficient for the full payment and discharge of all claims on account of all face-amount certificates sold by or on behalf of the debtor, and such deposit or transfer and every lien created thereby shall thereupon be avoided by the trustee subject to the provisions of paragraph 3 of this subdivision (f).

(3) In the event any deposit or transfer described in paragraph 2 of this subdivision (f) shall be avoided the trustee shall segregate the property received by the trustee from the depositary and charge the same with the costs and expenses of maintenance and liquidation and distribute the net proceeds thereof to the creditors who would have been entitled thereto under the provisions of the law or agreement providing for the deposit or transfer of the property, and each such creditor shall thereafter be entitled to divi-

dends from the estate only after all creditors of the same rank shall have received the same percentage.

(4) The court shall have summary jurisdiction of any proceedings to hear and determine the rights of any parties under this subdivision (f) and to hear and determine the sufficiency of the property of the estate for the full payment and discharge of all claims on account of all face-amount certificates sold by or on behalf of the debtor. Due notice of any hearing in such proceedings shall be given to every depositary and State agency which is a party in interest.

(5) Where the provisions of subsection (c) of section 28 are not applicable, the provisions of this section will not apply.

15 U. S. C. A. 80a-3 (c) (3) and (6). Notwithstanding subsections (a) and (b), none of the following persons is an investment company within the meaning of this subchapter and sections 72 (a), last sentence, and 107 (f) of Title 11:

(3) Any bank or insurance company; any savings and loan association, building and loan association, cooperative bank, homestead association, or similar institution, or any receiver, conservator, liquidator, liquidating agent, or similar official or person thereof or therefor; • • •

(6) Any person who is not engaged in the business of issuing face-amount certificates of the installment type or periodic payment plan certificates, and who is primarily engaged in one or more of the following businesses: (A) Purchasing or otherwise acquiring notes, drafts, acceptances, open accounts receivable, and other obligations representing part or all of the sales price of merchandise, insurance, and services; (B) making loans to manufacturers, wholesalers, and retailers of, and to prospective purchasers of, specified merchandise, insurance, and services; and (C) purchasing or otherwise acquiring mortgages and other liens on and interests in real estate.

**State Statutes.**

West Virginia Code, Ch. 33, Art. 9, Sec. 1:

(1) License from Insurance Commissioner Prerequisite to Engaging in Business.—No person, association or corporation shall engage in the business of soliciting or receiving deposits or payments on any annuity contract or certificate or annuity bond in fixed and stipulated installments, within this State, without first having obtained from the insurance commissioner a license to do business in this State: Provided, however, That this article shall not be construed as applying to persons, associations or corporations engaged in selling merchandise in installments, insurance companies, foreign or domestic, duly authorized to do business in this State, building and loan associations, national banks and banking institutions organized and authorized to do business under the laws of this State, fraternal insurance societies, or surety companies doing business under the laws of this State. Such license shall be issued for one year, or the fractional part of a year, and for issuing the same a fee of ten dollars shall be charged; and the provisions of section twelve, article two of this chapter shall apply to such license.

West Virginia Code, Ch. 33, Art. 9, Sec. 2:

(2) License Prerequisite to Negotiating Contracts.—No person, association or corporation shall sell or offer for sale or deliver within this State any contract, certificate or bond of any person, association or corporation required by this article to obtain a license from the insurance commissioner to transact business in this State until such license has been issued by said insurance commissioner.

West Virginia Code, Ch. 33, Art. 9, Sec. 3:

(3) Deposits to be Made with the Treasurer.—Before a license to transact business in this State shall be issued by the insurance commissioner to any person, association, or corporation within the purview of section one of this article, the insurance commissioner shall require the

applicant to deposit with the state treasurer (in accordance with article five, chapter twelve of this code), in trust, for the benefit of its contract holders, bonds of the state of West Virginia, or such other bonds, and securities including bonds issued by the West Virginia bridge commission as may be approved by said insurance commissioner, or both, to the aggregate amount of one hundred thousand dollars, and, in addition to such deposit, such person, association or corporation shall maintain at all times a deposit with the state treasurer of bonds and securities approved by the insurance commissioner to an amount equal to the total amount which such person, association or corporation may be liable to pay in cash to the holders of all contracts under the terms thereof at the time of the deposit: Provided, That when, by the laws of any other state, any such person, association or corporation shall have been required to make and shall have made such deposit in such state, equal or greater in amount for the benefit of contract holders in such state, upon the filing of a certificate to such effect from the proper officer in such state with the insurance commissioner of this State, such person, association or corporation shall not be required to make such deposit with the treasurer of this State for the benefit of its contract holders in such other state; and when the laws of any other state require such deposit less in amount, such person, association or corporation shall file a certificate from the proper officer in such state with the insurance commissioner of this state showing the amount of the deposit made, and shall deposit with the treasurer of this state an amount which, together with the deposit made in such other state, shall make up the total amount required by this state to be deposited by such person, association or corporation, and such contract holders in such other state shall not be entitled to the benefit of the securities deposited with the treasurer of this State under this article, except so much of such deposit as may be made to complete the total amount required by this article where the law of any other state requires a lesser amount.

The insurance commissioner may require an independent appraisal, at the expense of the company, of any property

on which it holds a mortgage or trust deed or any bond or other investment offered by such company for the purpose of complying with the deposit provisions of this article.

West Virginia Code, Ch. 33, Art. 9, Sec. 5:

(5) Revocation of License on Failure to Make Additional Deposits or Insufficiency of Assets.—On the failure of such person, association or corporation to deposit such additional bonds and securities with the state treasurer when so required by the insurance commissioner, the license to do business in this State shall be revoked by the insurance commissioner. Whenever the insurance commissioner, upon an examination of the affairs of any such person, association or corporation, finds that the liabilities of such person, association or corporation exceed the assets thereof, the insurance commissioner shall suspend the license of such person, association or corporation until he is satisfied that the assets of such person, association or corporation are increased to exceed said liabilities.

West Virginia Code, Ch. 33, Art. 9, Sec. 10:

(10) Authority of Insurance Commissioner; Control of Deposit Where License Revoked.—The insurance commissioner shall have the same authority over every person, association, or corporation engaged in selling annuity contracts, certificates, or bonds, as over insurance companies, and if in his opinion the assets are impaired or such person, association or corporation is not complying with the law, said commissioner shall have authority to revoke the license of such person, association, or corporation to do business in this State, and, if such license is so revoked, the deposit or a sufficient amount of same, shall remain under the authority and control of the insurance commissioner until the total liability of all the contracts, certificates or annuity bonds or contracts issued by such person, association or corporation of this State is redeemed or settled.

West Virginia Code, Ch. 33, Art. 2, Sec. 5:

(5) Issuance of License by Insurance Commissioner.—Upon receiving such certified copy and statement, the in-

surance commissioner may examine such company or association, and if he finds that it has complied with the terms of its charter or articles of association and the laws of this State, and with all the provisions in other sections of this chapter prescribing conditions precedent to the issuance of a license, or certificate of authority, and is satisfied that it is solvent (or if chartered or organized under the laws of any foreign country, is solvent in the United States), he may issue to it a license, or certificate of authority, stating such facts and authorizing it to issue policies, make contracts of insurance, and transact business in this State.

West Virginia Code, Ch. 33, Art. 2, Sec. 12:

(12) Time Licenses Shall Continue in Force.—All licenses, or certificates of authority issued by the insurance commissioner to insurance companies or associations, or agents, solicitors or brokers, shall continue in force until the first day of April next following their issuance, unless the same be sooner revoked.

West Virginia Code, Ch. 33, Art. 2, Sec. 45:

(45) Proceedings in Circuit Court of Kanawha County against Insolvent Company.—Whenever any company under the supervision and regulation of the insurance commissioner shall become insolvent or shall be in such financial condition as not to be able to pay its creditors in this State, the commissioner of insurance may file a bill in the circuit court of Kanawha county for the administering of the assets of such company as an insolvent, and for the purpose of taking possession of its property in this State and the distribution of its assets among those entitled thereto according to their respective right.

West Virginia Code, Ch. 33, Art. 3, Sec. 7:

(7) Annuities May Be Issued by Life Companies.—Life insurance companies chartered by and doing business in this State, and empowered to make contracts contingent upon life, may grant and issue annuities, either in connection with or separate from contracts of insurance based

upon life risks, and all such annuities heretofore issued by such companies shall be valid.

Ch. 46 of Acts of 1941:

(1) Definitions.—For the purposes of this article the term "face-amount certificate" shall mean any certificate, investment contract, or other security which represents an obligation on the part of its issuer to pay a stated or determinable sum or sums at a fixed or determinable date or dates more than twenty-four months after the date of issuance in consideration of the payment of periodic installments of a stated or determinable amount; or any security which represents a similar obligation on the part of its issuer, the consideration for which is the payment of a single lump sum.

All other terms used herein shall have their respective meanings, as provided in section two, article one of this chapter.

(2) When Certificates Exempt from Registration.—Face-amount certificates issued by a person licensed and supervised by the insurance commissioner of this state shall be exempt from registration under the provisions of this article.

(3) Restriction on Sale.—No face-amount certificates, except those exempt under the provisions of section two hereof, shall be sold within this state unless such face-amount securities shall have been registered as hereinafter provided.

(4) Registration of Certificates.—Face-amount certificates shall be registered hereunder by the filing of an application with the commissioner by the issuer or by any dealer properly registered under the provisions of section twelve, article one of this chapter: Provided, That the issuer of such certificates is registered under the provisions of an act of Congress entitled "Investment Company Act of 1940." Such application is to be in the form prescribed by the commissioner. With each such application there shall be filed a certified copy of the registration statement

which was filed by the issuer of such certificates with the securities and exchange commission pursuant to the provisions of section eight of the said "Investment Company Act of 1940."

The commissioner may require that the applicant file with him such additional data and information respecting the issuer as he shall deem necessary and pertinent to registration hereunder.

The commissioner shall have power and authority to place such conditions, limitations and restrictions on any registration as may be necessary to carry out the purposes of this article.

(5) Fees for Registration.—At the time of filing the application mentioned in section four of this article, the applicant shall pay to the commissioner a fee of one-twentieth of one per cent of the aggregate face-amount of the certificates to be sold in this state for which the applicant is seeking registration, but in no case shall such fee be less than twenty-five dollars, nor more than three hundred dollars.

(6) Expiration of Registration; Reregistration.—Every registration under this article shall expire on the thirtieth day of June in each year. New registrations for the succeeding year shall be issued upon written application, the applicant furnishing the commissioner, upon request, information as hereinbefore provided, and paying the commissioner a fee on the basis specified in section five of this article on the aggregate face-amount of the certificates to be sold in this state within the year to be authorized by registration. Applications for renewal registration must be made not less than thirty days before the first day of the ensuing registration year, otherwise they shall be treated as original application.

(7) Non resident Issuer to File with Application for Registration Written Appointment of State Auditor as Attorney in Fact; Service and Acceptance of Process.—When any issuer of face-amount certificates shall not be domiciled in this state, he shall file with every application for registration hereunder (whether such application be made by the issuer in person or by or through a registered dealer)

his irrevocable written appointment of the state auditor, or his successor in office, to be his true and lawful attorney in fact, who may accept or upon whom may be served, any lawful process or pleading in any action or proceeding against him in any court of record in this state, and such filing shall constitute his consent that any such process or pleading against him, which is properly served upon the state auditor or is accepted by the state auditor, shall be of the same legal force and validity as process or pleading duly served upon said issuer in this state. In case any process or pleading is served upon the state auditor, or accepted by him, such service shall be made in duplicate, one copy of which shall be filed in the office of the state auditor and the other immediately forwarded by registered mail to the principal office of the issuer against whom such process or pleading is directed.

(8) Sales to Be Made Only by Registered Dealers.—Face-amount certificates shall be offered for sale and sold in this state only by dealers and salesmen registered with the commissioner under the provisions of section twelve, article one of this chapter.

(9) Violations; Penalties.—Any person subject to the provisions of this article, who shall sell or offer for sale any face-amount certificates within this state without complying with the provisions of this article, or who continues to sell or offer for sale any such certificates after his registration has expired, or has been revoked or suspended by the commissioner, or who shall otherwise neglect or refuse to comply with any of the provisions of this article, shall be guilty of a felony, and upon conviction thereof, shall be punished by a fine of not more than five thousand dollars, or by imprisonment in the penitentiary for not more than five years, or by both such fine and imprisonment, in the discretion of the court.

(10) Applicability of Sections.—Sections three, four, six, nine, and twenty-seven, article one of this chapter, shall not apply to this article. All other sections of this chapter shall apply fully to this article.

(11) Provisions Severable.—If any part or section of this act shall be declared unconstitutional or invalid by any court, such declaration shall not affect any other part or section hereof.

(12) Article Nine, Chapter Thirty-three, Repealed.—Article nine, chapter thirty-three of the code of West Virginia, one thousand nine hundred thirty-one, is hereby expressly repealed.

## APPENDIX B.

### State of West Virginia Certificate.

I, Stuart F. Reed, Secretary of State of the State of West Virginia, do hereby certify that a Resolution and New Agreement duly acknowledged and accompanied by the proper certificates and affidavits, have this day been delivered to me, which Resolution and New Agreement are in the words and figures following:

Whereas, It is deemed desirable by the stockholders of the Fidelity Investment Association, a corporation created and organized under the laws of the State of West Virginia, that the objects and purposes for which it was incorporated be enlarged; therefore be it

Resolved, By the stockholders of said corporation in stockholders' meeting assembled. That the objects and purposes for which said corporation was incorporated be enlarged, in accordance with and by virtue of the authority of Section ten of chapter fifty four of the Code of West Virginia, so that said objects and purposes hereafter shall be those set forth in the following new agreement, which new agreement is hereby adopted to-wit:

I. The undersigned agree to be and continue a corporation by the name of Fidelity Investment Association.

II. The Principal Place of Business of said corporation shall be located as heretofore at No. 1229 Main Street in the City of Wheeling, in County of Ohio, and State of West Virginia. Said corporation shall have no chief works.

III. The objects and purposes for which this Corporation is formed are as follows:

To purchase, acquire, buy, sell, own, hold, dispose of and deal in stocks, bonds, mortgages, debentures, obligations, and other securities of corporations and persons for its own account and for others on commission; to loan money on real estate security; to loan money on personal and other security; to acquire, own, deal in and sell real estate, to erect houses thereon, rent and sell the same, to lay out real estate into divisions and [illegible]s and to sell and dispose of same; to deal in real estate and to buy, sell and exchange the same for others for a commission or reward; to underwrite in whole or in part any issue of stocks, bonds or other securities; to transact as agents on commission the general business of real estate and insurance in all its branches; to transact on commission the general business of a fiscal agent; to transact any other business incident to any of the above named enterprises which a person, firm or partnership might engage in or do.

To carry on, by purchasing existing businesses, or otherwise, the business of soliciting or receiving deposits or payments on any annuity contracts, certificates or annuity bonds; in fixed and stipulated instalments or otherwise; to acquire and sell and offer for sale or delivery any contract, certificate or bond, of any person, association or corporation, now or hereafter engaged in this state in the business of soliciting, or receiving deposits or payments of any kind of annuity contracts, certificates or annuity bonds; and further to engage in the business of placing or selling certificates, bonds, debentures, certificates of interest, or investment securities of any kind on the partial payment, instalment, or any other plan of payment, and providing for the sale, redemption, or retiring of the same or any part thereof; and generally to carry on all lawful business necessary or incidental to all or any of the above mentioned objects.

The designation of any one of the objects and purposes aforesaid is not intended and shall not be taken to be a

limitation or qualification upon any other of the said designated objects and purposes.

IV. The amount of the total authorized capital stock of said corporation will be Two Hundred Thousand ($200,000) dollars, divided into two thousand shares of par value of one hundred dollars each, of which authorized capital stock the amount of Ninety Seven Thousand Five Hundred dollars has been paid.

V. The names and post office addresses of all the stockholders and the number of shares of stock subscribed for by each, are as follows:

| *Name* | *Post Office Addresses* | *No. of Shares* |
|---|---|---|
| C. R. Hubbard | Wheeling, W. Va. | 120 |
| W. B. Irvine | Wheeling, W. Va. | 38 |
| J. F. Paull | Wheeling, W. Va. | 78 |
| Geo. W. Woods | Wheeling, W. Va. | 53 |
| J. D. Merriman | Wheeling, W. Va. | 206 |
| Frank Waterhouse | Wheeling, W. Va. | 50 |
| Mamie G. Waterhouse | Wheeling, W. Va. | 56 |
| August Rolf | Wheeling, W. Va. | 20 |
| Wheeler H. Bachman | Wheeling, W. Va. | 20 |
| H. W. Gee | Wheeling, W. Va. | 50 |
| J. A. Fletcher | Wheeling, W. Va. | 15 |
| J. M. Brown | Wheeling, W. Va. | 20 |
| Will S. Hohmam | Wheeling, W. Va. | 3 |
| E. W. Oglebay | Wheeling, W. Va. | 106 |
| Henry G. Stifel | Wheeling, W. Va. | 100 |
| Wm. H. Irvine | Wheeling, W. Va. | 25 |
| N. A. Haning | Wheeling, W. Va. | 15 |

VI. This Corporation is to expire fifty years from April 13, 1911.

VII. The President and Secretary of said corporation, by and with the advice and consent of the Board of Directors, may establish branches of said corporation, and make due and proper application to transact the business and there-

after transact the business of said corporation at any place or places in the United States or any foreign country.

Given under our hands this 9th day of December, 1912.

W. B. IRVINE.
J. D. MERRIMAN.
J. F. PAULL.
C. R. HUBBARD
H. W. GEE.
WHEELER H. BACHMAN.
FRANK WATERHOUSE.

WHEREFORE, The stockholders named in said New Agreement, and all the other stockholders of said corporation, and their successors and assigns, are hereby declared to be from this date until the Thirteenth day of April, 1961, a corporation by the name and for the objects and purposes set forth in said New Agreement; and that the said corporation shall henceforth be subject to such New Agreement as set forth in this Certificate in lieu of its original Certificate of Incorporation.

Given under my hand and the Great Seal of the said State, at the City of Charleston, this Tenth day of December, 1912.

(G. S.)

STUART F. REED,
*Secretary of State.*

STATE OF WEST VIRGINIA CERTIFICATE.

I, STUART F. REED, Secretary of State of the State of West Virginia, do hereby certify that J. F. Paull, President of Fidelity Investment & Loan Association, a corporation created and organized under the laws of the State of West Virginia, has certified to me under his signature and the corporate seal of said corporation, that, at a meeting of the stockholders of said corporation, regularly held in accordance with the requirements of the law of said State, at the office thereof, in the City of Wheeling, West Virginia, on the 30th day of November, 1912, at which meeting a majority of stock of such corporation being repre-

sented by the holders thereof in person or by proxy and voting for the following resolution, the same was duly and regularly adopted and passed, to-wit:

"RESOLVED, that the name of this corporation be changed from Fidelity Investment & Loan Association, its present name, to Fidelity Investment Association, by which latter name it shall hereafter be known."

WHEREFORE, I do declare said change of name to be authorized by law, and that the said corporation shall hereafter be known by the name of FIDELITY INVESTMENT ASSOCIATION.

Given under my hand and the Great Seal of the said State, at the City of Charleston, this Seventh day of December, 1912.

(G. S.)

STUART F. REED,
*Secretary of State.*

# SUPREME COURT OF THE UNITED STATES

## OCTOBER TERM, 1942

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# No. 319

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FIDELITY ASSURANCE ASSOCIATION, A CORPORATION, DEBTOR, AND CENTRAL TRUST COMPANY, TRUSTEE FOR FIDELITY ASSURANCE ASSOCIATION,
*Petitioners,*

vs.

EDGAR B. SIMS, AUDITOR OF THE STATE OF WEST VIRGINIA, AND EX-OFFICIO INSURANCE COMMISSIONER OF THE STATE OF WEST VIRGINIA; ROSS B. THOMAS AND H. ISAIAH SMITH, WEST VIRGINIA STATE COURT RECEIVERS; BANKING COMMISSION OF WISCONSIN; CHAS. R. FISCHER, COMMISSIONER OF INSURANCE AND PERMANENT RECEIVER FOR DEBTOR CORPORATION IN AND FOR THE STATE OF IOWA; JOHN B. GONTRUM, INSURANCE COMMISSIONER OF THE STATE OF MARYLAND; DEWEY S. GODFREY, MISSOURI STATE COURT RECEIVER; L. H. BROOKS, TRUSTEE, FREDERIC LEAKE AND A. L. GOLDBERG, JR., TRUSTEE; AND SECURITIES AND EXCHANGE COMMISSION,
*Respondents.*

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## MOTION AS TO RECORD.

To the Honorable the Chief Justice and the Associate Justices of the Supreme Court of the United States:

Now come your petitioners, Fidelity Assurance Association, a corporation, Debtor, and Central Trust Company, Trustee for Fidelity Assurance Association, and respectfully move the Court that, for consideration of the petition for certiorari to the United States Circuit Court of Appeals for the Fourth Circuit, the complete record in this case be

not printed, and that the said petition for certiorari be considered by this Honorable Court upon the appendices to the briefs filed in the Circuit Court of Appeals for the Fourth Circuit and the proceedings had in the said Circuit Court of Appeals.

---

The complete record in this case, much of which is irrelevant to the questions presented by the said petition, consists of approximately 4,000 pages of testimony and several thousand pages of exhibits. The statement of facts contained in the opinion of the District Court and the statement of facts contained in the opinion of the Circuit Court of Appeals fairly state the pertinent facts of the case, and the questions presented by the petition for certiorari can be decided on the portions of the record embodied in the said appendices, supplemented by the proceedings in the Circuit Court of Appeals.

A transcript of the complete record, duly certified by the Clerk of the United States Circuit Court of Appeals for the Fourth Circuit, has been filed with the Clerk of this Honorable Court, and if certiorari be granted by this Honorable Court as prayed by your petitioners, your petitioners will cause to be printed all of the record or so much thereof as counsel for the parties may by stipulation deem to be necessary.

Respectfully submitted,

JAMES R. FLEMING,
HOMER A. HOLT,
*Attorneys for Fidelity Assurance Association, Debtor.*
THOMAS C. TOWNSEND,
*Attorney for Central Trust Company, Trustee for Fidelity Assurance Association.*

JOHN V. RAY,
*Of Counsel for Fidelity Assurance Association, Debtor.*
HILLIS TOWNSEND,
JOHN T. KEENAN,
*Of Counsel for Central Trust Company, Trustee for Fidelity Assurance Association.*

(1757)

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IN THE

# Supreme Court of the United States

OCTOBER TERM, 1942

## No. 319

FIDELITY ASSURANCE ASSOCIATION, a corporation, Debtor, and CENTRAL TRUST COMPANY, Trustee for Fidelity Assurance Association,

*Petitioners,*

vs.

EDGAR B. SIMS, Auditor of the State of West Virginia, and Ex Officio Insurance Commissioner of the State of West Virginia; ROSS B. THOMAS and H. ISAIAH SMITH, West Virginia State Court Receivers; BANKING COMMISSION OF WISCONSIN; CHAS. R. FISCHER, Commissioner of Insurance and Permanent Receiver for debtor corporation in and for the State of Iowa; JOHN B. GONTRUM, Insurance Commissioner of the State of Maryland; DEWEY S. GODFREY, Missouri State Court Receiver; L. H. BROOKS, Trustee, FREDERIC LEAKE and A. L. GOLDBERG, JR., Trustee; and SECURITIES AND EXCHANGE COMMISSION,

*Respondents.*

**On Writ of Certiorari to the United States Circuit Court of Appeals for the Fourth Circuit**

## BRIEF OF PETITIONERS

JAMES R. FLEMING,
JOHN V. RAY,
HOMER A. HOLT,
*Counsel for Fidelity Assurance Association, Debtor.*
T. C. TOWNSEND,
HILLIS TOWNSEND,
*Counsel for Central Trust Company, Trustee for Fidelity Assurance Association.*

JARRETT PRINTING COMPANY, CHARLESTON, W. VA.

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IN THE

# Supreme Court of the United States

OCTOBER TERM, 1942

## No. 319

FIDELITY ASSURANCE ASSOCIATION, a Corporation, Debtor, and CENTRAL TRUST COMPANY, Trustee for Fidelity Assurance Association,

*Petitioners,*

VS.

EDGAR B. SIMS, Auditor of the State of West Virginia, and Ex-Officio Insurance Commissioner of the State of West Virginia; ROSS B. THOMAS and H. ISAIAH SMITH, West Virginia State Court Receivers; BANKING COMMISSION OF WISCONSIN; CHAS. R. FISCHER, Commissioner of Insurance and Permanent Receiver for Debtor Corporation in and for the State of Iowa; JOHN B. GONTRUM, Insurance Commissioner of the State of Maryland; DEWEY S. GODFREY, Missouri State Court Receiver; L. H. BROOKS, Trustee, FREDERIC LEAKE and A. L. GOLDBERG, JR., Trustee; and SECURITIES AND EXCHANGE COMMISSION,

*Respondents.*

**On Writ of Certiorari to the United States Circuit Court of Appeals for the Fourth Circuit**

## BRIEF OF PETITIONERS

### OPINIONS BELOW

The opinion of the District Court is a part of the record (176), and is reported in 42 F. Supp. 973.

The opinion of the Circuit Court of Appeals, Fourth Circuit, is a part of the record (238) and is reported in 129 F. (2d) 442.

## JURISDICTION

The jurisdiction of this Court rests upon Section 240(a) of the Judicial Code, as amended by the Act of February 13, 1925 (28 USCA 347), and Sections 24(c) and 121, as added June 22, 1938, of the Bankruptcy Act (11 USCA 47(c) and 521).

## STATUTES INVOLVED

### Federal Statutes

The issues involve the construction and application to the facts of this case of the Bankruptcy Act, particularly Section 4 of Chapter III as amended (11 USCA 22) and Sections 106(3), 144, and 146 of Chapter X (11 USCA 506(3), 544 and 546), and of the Investment Company Act of 1940, Title I, particularly Sections 2(a)(15) and (17), 3(a)(2), 3(c)(3), 3(c)(6), 4(1), 6(a)2, 25, 28, 53 (15 USCA 80(a) with the same sections and subsections except that Section 53 of the Act is Section 52 in USCA) and Section 29(a) and (b) (11 USCA 107(f), 72 (a)).

Such pertinent provisions of these statutes as are not presented in the Argument are printed in the Appendix to this brief.

### West Virginia Statutes

The issues also involve a consideration of the following West Virginia statutes:

Chapter 33 of the Code of West Virginia (West Virginia Code of 1937, Annotated, Michie):

Article 9, Sections 1 to 12, inclusive;

Article 2, Sections 5, 12 and 45;

Article 3, Sections 1 and 7.

Chapter 46, Acts of the Legislature of West Virginia, 1941 (1941 Cumulative Supplement to the West Virginia Code of 1937, Michie, Chapter 32, Article 3; Chapter 33, Article 9).

Such pertinent provisions of these statutes as are not presented in the Argument are printed in the Appendix to this brief.

**Statutes of Other States**

A table of statutes of other states comparable to Section 3 of Article 9 of Chapter 33 of the Code of West Virginia relating to the deposits required to be made with state officials by companies such as Fidelity is found on page 24 of the Transcript of Record.

---

*Numbers in parentheses refer to pages of Transcript of Record unless otherwise indicated. Exhibits will be referred to by the abbreviation "Ex.", followed by the appropriate number or letter. Fidelity Assurance Association will usually be referred to as "Fidelity". The United States District Court for the Southern District of West Virginia will be referred to as the "District Court". The United States Circuit Court of Appeals for the Fourth Circuit will be referred to as the "Circuit Court". The proceeding in the Circuit Court of Kanawha County, West Virginia, will ordinarily be referred to as the "State Court proceeding", and said court will be referred to as the "State Court". There being proceedings in state courts of twelve different states, the context will show when reference to the state court proceedings comprises proceedings in more than one state court. Edgar B. Sims,*

*Auditor of the State of West Virginia and Ex Officio Insurance Commissioner, will frequently be referred to as the "State Auditor". Ross B. Thomas and H. Isaiah Smith, Receivers appointed by the Circuit Court of Kanawha County, West Virginia, will frequently be referred to as the "State Court Receivers" though that phrase may at times comprise receivers appointed in other states as well. Unless otherwise indicated, the "respondents" will refer to the respondents other than the Securities and Exchange Commission.*

## STATEMENT OF THE CASE

The material facts are presented in some detail in the opinion of the District Court (176) and in the opinion of the Circuit Court of Appeals (238). Condensed for the purposes of this brief, the facts of the case and the nature of the proceeding are as follows.

### Nature of the Proceeding

This proceeding arises under Chapter X of the Bankruptcy Act and was instituted by the filing of a voluntary petition for reorganization by Fidelity (4).

### Organization and Business of Fidelity

Fidelity was incorporated under the laws of the State of West Virginia, on April 11, 1911, under the name of Fidelity Investment and Loan Association and was authorized by its charter to buy, sell, and deal in stocks, bonds, and real estate. Fidelity's charter was amended in November, 1912, and its name was changed to Fidelity Investment Association. By the amended charter it was authorized to receive payments on annuity contracts in fixed installments or otherwise and to sell certificates, bonds, or other investment securities of any kind on installment or any other plan of payment (240; Ex. 20;

398). A copy of the charter powers of this charter is, for convenience, printed in the Appendix.

Under these charter powers from November, 1912, until December 31, 1940, Fidelity was engaged in selling its own securities in the form of investment contracts variously known as annuities, income contracts, or, more recently, face-amount installment certificates, and in investing the funds received from the purchaser (378). This activity brought Fidelity within the scope of Article 9, entitled Annuity Contracts, of Chapter 33, entitled Insurance and Annuity Contracts, of the Code of West Virginia requiring a license from the State Auditor, and by the provisions of Section 3 of said Article 9 (Appendix) the company was required to deposit securities with the State Treasurer as therein provided (178; 294-295; 365-366). Deposits in lesser amounts were also made with the statutory officials of some fourteen other states pursuant to the respective statutes, of the same general character as the West Virginia statute, of those States (Ex. C with Trustee's Report No. 2; 85; 347; 348). Insurance companies are expressly excluded from the provisions of the said Article 9 of Chapter 33 by Section 1 thereof (Appendix). Fidelity did business in fourteen other states which required no such deposits (348). A table of the deposits by states, as of the date of the filing of the petition in this proceeding, is found in the Opinion of the Circuit Court (242; Ex. 48), from which it will be noted that the deposits in West Virginia are substantially in excess of the liabilities to West Virginia creditors.

In the various states the activities of Fidelity were regulated by various officials or departments: in some, the securities department; in some, the banking department; and, in others, the insurance department (12-13; 348-373).

While the various types of investment contracts sold by Fidelity differ in some respects, they are all alike in providing for monthly, semi-annual or annual payments of specified sums, of which a sufficient portion was to be set aside in a reserve fund which was to produce the sum required to pay the purchaser the amount of money agreed upon in the contract (Ex's. 1, 2, 3, 4, 5; 305-316). The earlier contracts contained no statement as to the basis of the reserve fund. Of the later contracts, some provided for reserves on a 4½% basis and some on a 4% basis. All provided that the reserve fund so set aside should "be invested in approved securities and deposited in trust as required by the laws of the State of West Virginia" (179). In each of the contracts there was a provision whereby, with slight variation in language as to each particular class or series of contracts, Fidelity agreed to create and maintain a reserve fund for such particular class or series from payments made on contracts of that particular class or series, which reserve fund was to be used for the discharge of its liabilities on that particular class or series of contracts; and on its books Fidelity kept these various series funds separate and distinct (180; 319; 331; 376; 380; Ex. 25). Some of these series funds, the later and larger ones, are solvent (Ex. 70, 751; 492-493; 632-633; Ex. 21, 398; 1215). As a whole Fidelity is about 90% solvent (196; 242). There are approximately 88,000 contract holders, whose individual claims are relatively small (242; 479; Ex's. J and L with Trustee's Report No. 2, 86-87; Ex. 34, 515).

About 1934 Fidelity issued a contract known as the "Income Reserve Contract Series B", commonly referred to as the "Series B Contract" (Ex. 4, 315), the sale of which from that time on until December 31, 1940, constituted the major portion of its business (312; 315; 680).

The Series B Contracts contained the following provision:

> "SECTION 1. Reserve Fund. The Association shall create and maintain a Reserve Fund, as a Special Fund, solely for the discharge of its liability upon its Income Reserve Contracts Series B and its paid-up contracts issued in lieu thereof. * * *"

The Series B Contracts also contained an optional provision, "Section 6", under the terms of which Fidelity had arranged with an insurance company for life insurance by a multiple life policy or equivalent individual policies (236A) covering the original registered holder of the contract, provided he be in good health and be accepted by the insurance company (1047), the policies providing that upon the death of the registered holder the insurance company would pay to Fidelity the amount required by Fidelity to declare the contract fully paid (178; 244; 313-315). Fidelity arranged with the Lincoln National Life Insurance Company to carry such insurance (230-231; 416). Approximately 67% of the series B Contracts contain Section 6, the insurance provision (681), and from the standard monthly payment of $7.50 but 50¢ per month for the first sixty months and 25¢ per month for the next sixty months was allocated to the insurance (683; 771).

In December, 1938, the Securities and Exchange Commission filed a bill for injunction against Fidelity in the District Court of the United States for the Eastern District of Michigan alleging that Fidelity was engaged in acts and practices in the sale of its securities which constituted violations of the provisions of the Securities Act of 1933 (328), and in that cause a consent decree was entered, among other things, enjoining Fidelity from failing to meet the deposit requirements of the several states

(612; Appendix X of Ex. 6, Report of the SEC on Investment Companies). In the same month a suit for the appointment of receivers was brought by certain contract holders of Fidelity in the United States District Court for the Northern District of West Virginia based on the facts developed in the suit in Michigan; but the bill was dismissed by the district court for the reason that insolvency was not established, and the decision was affirmed by the Circuit Court of Appeals (*Hutchinson* v. *Fidelity*, 106 F. (2d) 431).

**The Investment Company Act of 1940**

Congress enacted the Investment Company Act of 1940, effective as to face-amount certificate companies on January 1, 1941 (54 Stat. 789, 15 USCA 80a-52), wherein Congress found that investment companies issuing face-amount installment certificates were affected "with a national public interest" (242; 15 USCA 80a 1(a)) and enacted regulations to govern the sale of face-amount certificates, with which it was immediately apparent that Fidelity could not comply (243; 630; 701).

**Attempted Extra Judicial Reorganization**

In a futile effort to meet the situation, on December 31, 1940, Fidelity's corporate charter was amended, and its objects and powers were stated to be, "to issue insurance upon the lives of persons and every insurance appertaining thereto and connected therewith, and to grant, purchase and dispose of annuities", and its name was changed to Fidelity Assurance Association (243; 405; 701). Fidelity had not previously had charter powers to issue contracts of insurance (Ex. 20, 398; Appendix).

Under the West Virginia statutes (Code 33-9-1 and 33-2-12, Appendix) Fidelity's license, under said Article 9, to issue face-amount installment certificates would not

expire until April 1, 1941. The West Virginia Auditor issued Fidelity a license as an insurance company for the period from January 1, 1941, to April 1, 1941, but with the requirement on the part of the Auditor and the agreement on the part of Fidelity that no insurance would be sold and no new annuity contracts would be sold (227; 246; 406; 438; 701; 940-941). Except as it may be contended that the sending out of certain riders, hereafter mentioned under the subtitle "Proceedings in the Circuit Court of Appeals", to be attached to certain Series B Contracts, containing Section 6, already in existence, were in violation of the agreement, Fidelity observed the agreement and sold no insurance contracts, sold no annuity contracts, did no business by virtue of this license, and no changes were made in the books of Fidelity, no transfers were made and no surplus was set up (230-232; 406; 416; 438; 529; 541).

**State Suits**

Fidelity made application for a license as an insurance company for the year commencing April 1, 1941, but the Auditor of West Virginia withheld the license applied for and on April 4, 1941, directed Fidelity to discontinue business (231-232; 246; 406; 702). On April 11, 1941, the State Auditor, pursuant to Chapter 33, Article 2, Section 5 of the West Virginia Code, apparently in collaboration with Fidelity (944; 1190-1192), "for the purpose of rehabilitating and reorganizing" Fidelity (1204; Ex. 70, 751; 579), filed a bill (Ex. 21, 398) in the Circuit Court of Kanawha County, West Virginia, to take possession of the assets of Fidelity, and, Fidelity consenting thereto, receivers were appointed by said court (1192). The Auditor of West Virginia notified corresponding officials in the other states in which Fidelity was doing business (1215) and corresponding proceedings were promptly instituted in eleven other states (246; Ex. 29, 489; 499; 108).

**Proceedings in the District Court**

On June 6, 1941, Fidelity filed its petition in the United States District Court for the Southern District of West Virginia alleging insolvency and praying for reorganization under the provisions of Chapter X of the Bankruptcy Act (6). On the same day, by ex parte order, the petition was approved and your petitioner, Central Trust Company, was appointed trustee (1). On June 10, 1941, the District Court directed the various state officials and court receivers to deliver to the trustee all property of the debtor in their hands (11). On August 9, 1941, while the plenary hearing was in progress and after certain answers and motions of intervenors had been filed, the District Court modified the orders of June 6 and June 10, 1941, requiring the state officials and receivers to turn over to the trustee the assets of the debtor by revising the turn-over requirements and enjoining state officials and receivers from disposing of such assets (102). The West Virginia receivers, under protest (80-81) and the Ohio receiver, without protest (507-508), turned over to the trustee the property of the debtor in their respective custodies, while the other state officials and receivers generally retained possession of the deposits in their custodies (247).

The Auditor of West Virginia, the receivers appointed in the state court proceeding in West Virginia, officials of other states, receivers appointed by other state courts, and others were permitted to intervene and file answers and motions controverting the allegations of the petition and denying the jurisdiction of the District Court for various reasons, among others, that Fidelity was an insurance company and not subject to the provisions of Chapter X of the Bankruptcy Act, though the respondent Sims, State Auditor, originally admitted under oath that Fidelity was not an insurance company and was a corpo-

ration which could be adjudged a bankrupt (59), thereafter amending his answer (127), and that the petition was not filed in good faith; and the intervenors moved that the petition be dismissed and the turn-over orders be vacated (31; 48; 58; 79; 91; 93; 96; 118; 176-177; 186).

A protracted plenary hearing was had in the District Court after which the District Court found that Fidelity was not an insurance corporation, that the petition was filed in good faith, that the principal assets of Fidelity had been in the Southern District of West Virginia during the six months next preceding the filing of the petition, and that the filing of the petition, though not properly authorized originally, had been ratified by proper corporate action (187-202); and the District Court, by decree of January 5, 1942, approved the petition (175-176).

During the hearing, many witnesses testified that Fidelity could and should be reorganized (706-710; 732-737; 630-633; 689-692; 700-705; 479-481; 486-487; 450-451; 457; 415; 421; 322-323; 336-338; 525; 528; 544-545; 1105; 896; 942; Ex. 90, 802). Some memoranda looking toward the formulation of plans were presented (259; Ex's. 111, 112, 1075; Ex. 113, 1077; 1069; 1067), but no definite plan was acted upon by the District Court.

**Proceedings in the Circuit Court of Appeals**

The respondents, other than the Securities and Exchange Commission, appealed from the decree of the District Court to the Circuit Court. The respondent West Virginia Auditor filed in the Circuit Court a petition for the remand of the case to the District Court (217) and, for the first time, by said petition for remand, introduced into the record a showing that on December 31, 1940, Fidelity had sent out to the holders of Series B Contracts containing Section 6 a letter and certain riders in duplicate, one to be signed and returned to Fidelity and

the other to be attached to the contract, by which Fidelity would assume the insurance obligations of such Series B Contract (218-219), and in the hearing in the Circuit Court of Appeals it was stipulated that 9,802 of these riders had been signed by the contract holders and returned to Fidelity (237). Fidelity did not in fact assume such insurance obligations for the reason that Fidelity was never authorized by the Auditor of West Virginia to engage in the insurance business (230; 406; 416; 438; 529; 541), and the insurance obligations continued to be carried by the Lincoln National Life Insurance Company as before (231).

The Circuit Court found that Fidelity was an insurance company, not eligible for reorganization under Chapter X of the Bankruptcy Act, and that the petition had not been filed in good faith, apparently on the grounds that it was unreasonable to expect that any plan of reorganization could be effected (Sec. 146(3)) and that the interests of creditors would be best subserved in the prior proceedings pending in the state courts (Sec. 146(4)), reversed the judgment of the District Court and remanded the cause with instructions to the District Court to dismiss the petition (248-264).

The decree of the Circuit Court reversing the decree of the District Court and remanding the cause with instructions to dismiss, was entered on the 16th day of June, 1942 (263). The debtor, on the 13th day of July, 1942, presented its petition for a rehearing (264) to the Circuit Court which petition was denied by order of July 22, 1942 (267).

Upon application for a stay of the mandate, by assent of counsel, the Circuit Court entered an order on July 22, 1942, staying the mandate upon the condition that petition for certiorari be presented to this Court within thirty days, and modified the order of the District Court of Aug-

ust 9, 1941, so as to permit the various state officials and receivers to sell assets in their custody for the purpose of conserving the estate (268). Learning that some of the respondents considered the modification of the order of August 9, 1941, by the order of July 22, 1942, as a license to sell the assets in their custodies for liquidation, your petitioners, on August 7, 1942, filed a motion in the Circuit Court for modification of the amendatory order of July 22, 1942, so as to make it clear that the consent to the sale or exchange of assets was for conservation only and not for liquidation (271). This motion was set down for consideration at the next term of the Circuit Court (285). The presentation to this Court of the petition for certiorari and the subsequent granting of the petition apparently made further pressing of said motion unnecessary.

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Petition for writ of certiorari was granted by this Court on October 12, 1942 (286; 87 L. ed. (Adv.) 33).

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## SPECIFICATION OF ERRORS URGED

The United States Circuit Court of Appeals for the Fourth Circuit erred:

1. In holding that the debtor, Fidelity, was an insurance corporation within the meaning of the Bankruptcy Act, Section 4 of Chapter III, and, particularly, Section 106(3) of Chapter X thereof, and, therefore, ineligible to file a petition for reorganization under Chapter X of the Bankruptcy Act.

2. In holding that Fidelity's voluntary petition for reorganization was not filed in good faith as defined by Section 146 of the Bankruptcy Act.

3. In refusing to affirm the order of the District Court approving the petition and in reversing the judgment of said District Court and remanding the case with instructions to dismiss the petition.

## SUMMARY OF ARGUMENT

I. THE CIRCUIT COURT ERRED IN HOLDING THAT FIDELITY WAS AN INSURANCE CORPORATION INELIGIBLE TO FILE A PETITION FOR REORGANIZATION UNDER CHAPTER X OF THE BANKRUPTCY ACT.

(1) By the Investment Company Act of 1940, the Congress clearly and definitely classified companies engaged in business activities such as those engaged in by Fidelity as "face-amount certificate companies", one type of investment company, and as companies other than insurance corporations.

(2) By the laws of the State of West Virginia, the state of incorporation, Fidelity was definitely classified as an annuity company as distinguished from an insurance company, and as a corporation other than an insurance corporation.

(3) Fidelity did not have charter powers to issue insurance contracts prior to the December 31, 1940, amendment to its charter, and the business engaged in and carried on by Fidelity was that of selling and issuing annuity contracts, and not insurance contracts.

(4) The charter amendment of December 31, 1940, was procured as one step in an abortive effort to effect a voluntary, extra-judicial reorganization of Fidelity, and neither the procuring of the charter amendment nor the doing of any act thereafter by Fidelity transformed Fidelity into an insurance company within the meaning of the term as used in the Bankruptcy Act, as defined in the Investment Company Act of 1940, or in fact.

II. The Circuit Court Erred In Holding That the Petition of Fidelity, Filed Under Chapter X of the Bankruptcy Act, for Reorganization, Was Not Filed In Good Faith.

(1) That Fidelity had assented to the West Virginia State Court proceeding did not preclude Fidelity from filing its voluntary petition for reorganization under Chapter X of the Bankruptcy Act.

(2) The record not only does not show that "it is unreasonable to expect that a plan of reorganization can be effected", but, to the contrary, does show that it is quite reasonable to believe that a plan of reorganization can be effected.

Reorganization under Chapter X of the Bankruptcy Act is not limited to, and need not be, the complete rehabilitation of Fidelity as a going concern.

(3) The assets of Fidelity are physically located in many states. Already there are pending twelve separate proceedings in the courts of as many states. None of the state proceedings is under a state reorganization statute, and there is no prior proceeding pending in which the interests of the creditors are provided the safeguards afforded by Chapter X or in which the interests of creditors would be best subserved.

## ARGUMENT

I. The Circuit Court Erred in Holding That Fidelity Was An Insurance Corporation Ineligible to File a Petition for Reorganization Under Chapter X of the Bankruptcy Act.

### Introduction

It is believed that this point can be presented more clearly by first considering Fidelity and its activities dur-

ing the period of its unrestricted operations prior to December 31, 1940, when it ceased seeking new business and confined its activities to the receipt of installment payments on face-amount certificate contracts previously sold, and to the management of its properties and investments (406), and when, by charter amendment, it first obtained charter powers to issue life insurance policies and was licensed by the State Auditor as an insurance company (227), but licensed only upon condition that it issue no contracts of insurance and no new face-amount certificate contracts (438; 940-941). We shall then present the reasons why we believe that the character of Fidelity —from the point of view of eligibility to file a petition for reorganization under Chapter X—was not thereafter changed from that of a face-amount certificate company, eligible, to that of an insurance corporation, ineligible.

(1)

**By the Investment Company Act of 1940, the Congress Clearly and Definitely Classified Companies Engaged in Business Activities Such as Those Engaged in by Fidelity as "Face-amount Certificate Companies", One Type of Investment Company, and as Companies Other Than Insurance Corporations.**

It cannot be doubted that the Congress may, by reasonable classification, select the persons and corporations eligible for bankruptcy, voluntary or involuntary. *International Shoe Company* vs. *Pinkus*, 1928, 278 U. S. 261, 265; In re *Wisconsin Co-operative Milk Pool*, 1941, C. C. A. 7, 119 F. (2d) 999, 1002; *Kansas* vs. *Hayes*, 1932, C. C. A. 10, 62 F. (2d) 597, 599-600.

In fact, in the history of bankruptcy legislation, the Congress has at different times changed the classifications of eligibles and ineligibles. (See In re *Supreme Lodge of Masons*, 1923, D. C. N. D. Ga., 286 F. 180, 183).

By the Act of 1867 all moneyed, business or commercial corporations were made eligible for bankruptcy (Section 37, Act 1867). Under that Act, banks, railroads, building and loan associations, and insurance companies were all eligible for bankruptcy. The Act of 1898 provided for the bankruptcy of corporations principally engaged in manufacturing, trading, printing, publishing, mining or mercantile pursuits. The amendment of 1910 restored the general eligibility of moneyed, business or commercial corporations of the Act of 1867, but made the specific exceptions of municipalities, banks, railroads, and insurance corporations. Under that amendment building and loan associations were eligible for bankruptcy. More recently, under the Act of 1932 building and loan associations were added to the list of ineligibles. Neither the amendment of 1910 nor the amendment of 1938 specifically defined any of the excluded corporations.

Prior to 1910, whether or not a corporation was an eligible or an ineligible was determined by the principal activities of the corporation. (Remington, First Edition, Section 87). No doubt, in enacting the 1910 amendment, the Congress thought and intended that the classification of a corporation as an eligible or ineligible would continue to be determined by the corporate activities. We believe that, as will hereafter be argued, the business activities of the corporation have, in fact, continued to be recognized as the test (Remington, Fourth Edition, Section 92), though some confusion has been introduced into some of the decisions of some of the Circuit Courts of Appeals by resort to a supposed principle of selection, frequently referred to as the "state classification" principle.

Be that as it may, the Congress, by omitting to define the designated ineligibles in the amendments of 1910 and 1938, did not estop itself from providing a definition by some later act and, so far as distinguishing annuity, face-

amount certificate, companies from insurance companies, we believe the Investment Company Act of 1940 has provided in unmistakable terms the definitions of face-amount certificate companies and of insurance companies and that such definitions by said Act were made for the purposes, among others, of bankruptcy and reorganization, and that, under said definitions, Fidelity was clearly a face-amount certificate company and not an insurance company, not only prior to the charter amendment of December 31, 1940, but, as well, thereafter.

In this connection it is well to recognize that there is no occasion for any express provision or enactment that annuity companies or face-amount certificate companies, are or shall be eligible for bankruptcy. Such companies, unquestionably being moneyed, business and commercial corporations, are under the general and comprehensive provisions of the Bankruptcy Act and are eligible unless they be of one of the five types of corporations excluded: municipalities, banks, railroads, insurance, building and loan. It is not contended by the respondents that Fidelity is of any type of the ineligible corporations other than insurance.

So, if the Congress, with a view to bankruptcy, has said that face-amount certificate companies, such as Fidelity, are not insurance companies, Congress has, by implication, said that face-amount certificate companies are eligible for bankruptcy, just as clearly, effectively, and unmistakably as Congress might have done by adding to the Investment Company Act or to the Bankruptcy Act in express words a provision that face-amount certificate companies should be eligible for bankruptcy. Stated otherwise: the Investment Company Act of 1940 dealt with investment companies, and particularly with face-amount certificate companies, one type of investment company, defined such companies and expressly preserved

with respect to investment companies the jurisdiction of the district courts for reorganization under Chapter X of the Bankruptcy Act (Investment Company Act of 1940, Section 25, Appendix); and, further, for the purpose of distinguishing and exempting insurance companies, defined insurance companies. Said Act further expressly amended the Bankruptcy Act and inserted therein provisions for particular application to face-amount certificate companies, named as such (Investment Company Act, Section 29(b)). Therefore, when the Congress so recognized face-amount certificate companies as being within the provisions of the Bankruptcy Act by expressly reserving the jurisdiction for reorganization under Chapter X and by enacting particular provisions for application to face-amount certificate companies in bankruptcy, Congress meant face-amount certificate companies as defined in that Act. And a face-amount certificate company, as defined in said Act, is not an insurance company as defined in said Act.

By the Investment Company Act of 1940, Congress has defined a "face-amount certificate" as follows:

> "(a) When used in this subchapter and sections 72 (a), last sentence, and 107 (f) of Title 11, unless the context otherwise requires—*
>
> "• • •
>
> "(15) 'Face-amount certificate' means any certificate, investment contract, or other security which represents an obligation on the part of its issuer to pay a stated or determinable sum or sums

*Sections 72(a) and 107(f) of Title 11, Bankruptcy, are the provisions of the Investment Company Act of 1940, which expressly amended the Bankruptcy Act as such and in the following language:

Sec. 29. (a) Section 67 of an Act entitled "An Act to establish a uniform system of bankruptcy throughout the United States", approved July 1, 1898, as amended, is amended by adding at the end thereof the following:

at a fixed or determinable date or dates more than twenty-four months after the date of issuance, in consideration of the payment of periodic installments of a stated or determinable amount (which security shall be known as a face-amount certificate of the 'installment type'); or any security which represents a similar obligation on the part of a face-amount certificate company, the consideration for which is the payment of a single lump sum (which security shall be known as a 'fully paid' face-amount certificate)."

(15 U. S. C. A., §80a-2 (a) (15)).

Congress has defined an "investment company" as including the business of issuing face-amount certificates:

"(a) When used in this subchapter and sections 72(a), last sentence, and 107(f) of Title 11, 'investment company' means any issuer which

"• • •

"(2) is engaged or proposes to engage in the business of issuing face-amount certificates of the installment type, or has been engaged in such business and has any such certificate outstanding; or

"• • •"

(15 U. S. C. A. §80a-3 (a) (2)).

In fact, the "face-amount certificate company" is one of the three principal classes of investment companies:

"For the purposes of this subchapter and sections 72(a), last sentence, and 107(f) of Title 11, investment companies are divided into three principal classes, defined as follows:

"(1) 'Face-amount certificate company' means an investment company which is engaged or proposes to engage in the business of issuing face-

amount certificates of the installment type, or which has been engaged in such business and has any such certificate outstanding.

"* * *"

(15 U. S. C. A., §80a-4 (1)).

Congress has gone further. The Investment Company Act of 1940 expressly amended certain sections of the Bankruptcy Act for particular application to face-amount certificate companies. It prescribed a particular method for the selection of the trustee:

"* * * If the bankrupt is a face-amount certificate company, as defined in section 80a-4 of Title 15, the court alone shall make the appointment; but the court shall not make such appointment without first notifying the Securities and Exchange Commission and giving it an opportunity to be heard."

Aug. 22, 1940, c. 686, Title I, §29(b); 11 U. S. C. A., §72a.

The Investment Company Act particularly amends the Bankruptcy Act with respect to deposits or transfers of securities by face-amount certificate companies (Aug. 22, 1940, c. 686, Title I, §29(a); 11 U. S. C. A., §107f(1) (a); (Appendix), manifesting an unmistakable Congressional intent that face-amount certificate companies be within the provisions of the Bankruptcy Act. And Section 25 (15 U. S. C. A. 80a 25(d)) expressly recognizes and reserves the jurisdiction of district courts over investment companies under Chapter X relating to reorganization.

Counsel for the West Virginia respondents, in their brief in the Circuit Court, recognized that the Investment Company Act of 1940 provided for "bankruptcy of face-amount certificate companies."

The Investment Company Act does not stop with the defining of face-amount certificate companies but, for the purpose of contrasting investment companies, particularly face-amount certificate companies which are within the Act, with insurance companies which are excepted from the Act, defines an insurance company as follows:

> "(a) When used in this subchapter and sections 72(a), last sentence, and 107(f) of Title 11, unless the context otherwise requires—
>
> "• • •
>
> "(17) 'Insurance company' means a company which is organized as an insurance company, whose primary and predominant business activity is the writing of insurance or the reinsuring of risks underwritten by insurance companies, and which is subject to supervision by the insurance commissioner or a similar official or agency of a State; or any receiver or similar official or any liquidating agent for such a company, in his capacity as such."
>
> (15 U. S. C. A., §80a-2 (a) (17)).

Under this definition of an insurance company, even if the sending out by Fidelity of the riders to the Series B Contracts having the §6 (insurance) provisions were the making of insurance contracts as was concluded by the Circuit Court, we believe without thorough consideration, yet, Fidelity, would not be within the definition of an insurance company for the reason that, admittedly, the insurance features of the Series B Contracts were but incidental to the face-amount certificate contracts, the issuance of which was the primary and predominant business activity of Fidelity.

The Investment Company Act (15 U. S. C. A., 80a-3 (c) (3)), excludes an insurance company from the definition of an investment company, but face-amount certificate

companies not only are not so excluded but are expressly defined as investment companies and as one of the three principal divisions thereof (15 U. S. C. A., 80a 3(a) (2), 4 (1)).

Section 3 of the Investment Company Act (15 U. S. C. A., 80a-3 (c) (6)) shows that the issuing of face-amount certificates is one of the principal earmarks of an investment company.

In this particular case, Fidelity is not exempted from the provisions of the Investment Company Act or of the Bankruptcy Act by Section 6 of the Investment Company Act (15 U. S. C. A., 80a-6 (a) (2)) for the reason that there was no proceeding pending in a court of the United States or of a state in which a receiver was appointed for Fidelity prior to the effective date of said Investment Company Act, which was, as to face-amount certificate companies, January 1, 1941 (Aug. 22, 1940, c. 686, Title I, §53, 15 U. S. C. A., §80a-52). The State court proceedings were not instituted until April 11, 1941 (Ex. 70, 751).

In connection with some of the argument hereinafter, it is significant to observe that by the very definition of an insurance company in the Investment Company Act (15 U. S. C. A., 80a-2 (a) (17)), the nature of the organization of the company, including charter powers, and the character of the state supervision are but conditions precedent, so to speak, to acceptance of a company as an insurance company. The really determinative factor is made dependent upon the company's "primary and predominant business activity", which, in order that the company be so classified, must be "the writing of insurance or the reinsuring of risks underwritten by insurance companies, * * *."

The Circuit Court in observing

"* * * But this question need not be decided now, for, in our opinion, the scope of the provision by

> which municipal, railroad, insurance and banking corporations are excepted from bankruptcy proceedings is to be determined in any case *by the classification of the corporation under the law of the state of its creation rather than by the character of its predominant business activity.*" (Italics ours.) (248),

apparently overlooked the definition of an insurance company under the Investment Company Act when that Court said that the "predominant business activity" was not determinative, whereas Congress, using substantially the same terminology, had expressly provided that the "primary and *predominant business activity*" must be the writing of insurance if a company be considered an insurance company, as distinguished from an investment company.

Whatever may have been the status of the law prior to the enactment of the Investment Company Act of 1940, it is believed that by that Act the Congress has expressly defined corporations such as Fidelity as investment companies, companies other than insurance companies, and that the Circuit Court erred in finding that Fidelity was an insurance corporation.

(2)

**By the Laws of the State of West Virginia, the State of Incorporation, Fidelity was Definitely Classified as an Annuity Company as Distinguished from an Insurance Company, and as a Corporation Other Than an Insurance Corporation.**

It is not questioned that from 1912 to December 31, 1940, Fidelity operated under the provisions of Article 9, Chapter 33 of the West Virginia Code. Section 1 of said article (Appendix) expressly provides:

"• • • Provided, however, that *this article shall not be construed as applying to* persons, associations or corporations engaged in selling merchandise in installments, *insurance companies,* foreign or domestic, duly authorized to do business in this State, • • •." (Italics ours.)

If it can be said that the State classification of Fidelity is that Fidelity is an insurance company, then, by the very express terms of the article, enacted for the supervision and regulation of annuity companies, annuity companies, as insurance companies, are excluded from the operation of the statute, rendering the article, for all practical purposes, nugatory and without subject matter upon which to operate.

Again, the West Virginia statutes under which the state court proceeding was instituted in West Virginia (Code 33-9-10, 33-2-45, Appendix) provide that the insurance commissioner shall have the same authority in this respect over annuity corporations as he has over insurance companies. If Fidelity were an insurance company, there would be no reason for the enactment of any statute to make specifically applicable to annuity corporations the statutory provisions already applicable to insurance companies.

A corporation is not necessarily a banking, building and loan, or insurance corporation merely because it is chartered under laws relating generally to the banking, building and loan, or insurance business, or to the governmental departments which supervise or regulate them.

In the case *In re Prudence Co., Inc.,* C. C. A. 2, 1935, 79 F. (2d) 77, the corporation involved was formed under the article of the Banking Law of New York relating to investment companies, and was under the supervision of the superintendent of banking, but it was held not to be

a banking corporation within the meaning of the Bankruptcy Act. The Banking Law of New York was entitled "An Act in relation to banking corporations * * * and corporations under the supervision of the banking department".

So, with respect to Fidelity, the chapter of the West Virginia Code under which Fidelity operated was entitled "Insurance and Annuity Contracts", and, although insurance and annuity corporations may be dealt with by the same chapter of the West Virginia Code and may be under the supervision of the Insurance Commissioner, it cannot be contended that every corporation which operates under said Chapter 33 is an insurance company with any greater success than it was contended in the *Prudence* case that every corporation operating under the Banking Law of New York was a banking corporation. In Chapter 33 of the West Virginia Code there are different articles dealing with different types of corporations—particularly insurance corporations on the one hand and annuity corporations on the other—just as, under the New York Banking Law, there were different articles dealing with different types of corporations, including banking, trust, safe deposit, and investment companies. Article 9, Chapter 33 of the Code of West Virginia is the article under which annuity companies, defined by the Congress as face-amount certificate companies, have operated.

Likewise, in the case of *Gamble* v. *Daniel*, C. C. A. 8, 1930, 39 F. (2d) 447, the corporation involved, Peters Trust Company, was chartered under Title V of the laws of Nebraska. Article 19 of said Title V related to "Trust Companies," while Article 17 of said title related to "Banks." Although trust companies were invested with most of the powers usually exercised by a bank, the striking exception being that of receiving deposits, it was held,

and properly so, that the corporation involved was a trust company and not a banking company, and was subject to bankruptcy.

In *Capital Endowment Company* v. *Kroeger*, C. C. A. 6, 1936, 86 F. (2d) 976, 979, following the *Prudence* case, it was held:

> "* * * But the present debtor is not an insurance corporation. It was organized under the general incorporation law of Ohio, and while it later qualified as a bond investment company, it is not denied that it abandoned this field prior to the filing of its petition. *The mere fact that bond investment companies were placed under the supervision of the Superintendent of Insurance could neither enlarge their powers nor alter their business* * * *." (Italics ours.)

It is not without significance that the State Auditor, who, as ex-officio Insurance Commissioner, had supervised the activities of Fidelity for eight years, in his answer and controversion to the petition (59), which was duly verified by him (79), said:

> "* * *
>
> "Respondent admits that the debtor is a corporation which could be adjudged a bankrupt under the Federal Bankruptcy Act, and is not a municipal, insurance or banking corporation, or building and loan association, and is not a railroad corporation authorized to file a petition under the provisions of the Bankruptcy Act.
>
> "* * *"

As a matter of pleading this admission by the State Auditor was amended (127) upon motion of counsel for the State Receivers, assented to by counsel for Fidelity, but as a matter of evidence it may be questioned whether the

force of the sworn admission is materially lessened by the unverified amendment by counsel.

Apart from the effect of the Investment Company Act of 1940, it is earnestly believed that by the laws and administrative practices of the State of West Virginia Fidelity has been classified as a corporation other than an insurance corporation.

(3)

**Fidelity Did Not Have Charter Powers to Issue Insurance Contracts Prior to the December 31, 1940 Amendment to its Charter, and the Business Engaged in and Carried on by Fidelity was that of Selling and Issuing Annuity Contracts, and not Insurance Contracts.**

If thought be given to the multiple and diverse powers that are found in the charters of many corporations, the different types of state statutory provisions under which corporations are chartered, the different agencies by which corporations of some types are supervised or regulated, and the many different businesses in which a single corporation frequently engages, it is immediately apparent that a practical and orderly administration of the law permits one and only one real rule of classification; that is, the rule of classification based upon the primary and predominant business activity, usually referred to as the "corporate activities" test.

That is the principle which has been applied by this Court in determining whether a corporation, even though chartered under state insurance laws, is or is not an insurance corporation under the revenue statutes. *Bowers* v. *Lawyers Mortgage Co.*, 1931, 285 U. S. 182; *United States* v. *Home Title Insurance Co.*, 1931, 285 U. S. 191.

That is the principle adopted by the Congress in enacting the Investment Company Act of 1940, distinguishing investment companies from insurance companies.

In the last analysis that is the principle which has been applied even in the cases in which lip service has been given to the so-called "state classification" principle.

In adopting the definitions of the Investment Company Act of 1940, beyond doubt the Congress accepted and adopted the principle or test laid down by this Court in the *Lawyers Mortgage Company* and *Home Title Insurance Company* cases and, recognizing the impracticability of the so-called "state classification" principle or test as reflected by the decisions of various of the circuit courts of appeals which had attempted to apply the so-called "state classification" principle, adopted the real and practical test of business activities.

The only remnant of the so-called "state classification" theory found in the Investment Company Act definitions is that which would restrict, rather than extend, the corporations defined and thereby classified as insurance companies by limiting an insurance company to that "which is organized as an insurance company, * * *" and "* * * which is subject to supervision by the insurance commissioner or a similar official or agency of a state; * * *" even though the primary and predominant business activity of the corporation might be "the writing of insurance or the reinsuring of risks underwritten by insurance companies". In other words, even though the primary and predominant business activity of the corporation might be the writing of insurance, it would still not be an insurance company, under the Investment Company Act definition, unless it were organized as such and subject to supervision by a state insurance commissioner. On the other hand, even though such company might be so organized and subject to supervision by a state insurance commissioner, it would, nevertheless, not be an insurance company unless its primary and predominant business activity were the writing of insurance.

The so-called "state classification" theory has been practicable for application only in those situations where the business activities were clearly harmonious with the charter powers, their statutory source, and the nature of the regulatory agency, if there were a regulatory agency (See *Security B. & L. Association* v. *Spurlock*, C. C. A. 9, 1933, 65 F. (2d) 768; *Republic Underwriters* v. *Ford*, C. C. A. 5, 1938, 100 F. (2d) 511; *In re Pacific States Savings & Loan Co.*, D. C. S. D. Cal. C. D., 1939, 27 F. Supp. 1009; and *State of Kansas* v. *Hayes*, C. C. A. 10, 1932, 62 F. (2d) 597). On the other hand, where the nature of the charter powers and their statutory source have been debatable, the corporate activities have been actually relied upon even though lip service may have been given to the "state classification" theory. *In re Prudence Co., Inc.*, C. C. A. 2, 1935, 79 F. (2d) 77; *Clemons* v. *Liberty Savings, etc.*, C. C. A. 5, 1932, 61 F. (2d) 448; *Capital Endowment Co.* v. *Kroeger*, C. C. A. 6, 1936, 86 F. (2d) 976; *Gamble* v. *Daniel*, C. C. A. 8, 1930, 39 F. (2d) 447.

The "business activities" have been accepted as the true basis of classification when the inquiry was whether or not the corporation was a "moneyed, business or commercial corporation." *In re Roumanian Workers Association of America*, C. C. A. 6, 1940, 108 F. (2d) 782; *Schuster* v. *Ohio Farmers Co-op. Milk Association*, C. C. A. 6, 1932, 61 F. (2d) 337.

Where the Circuit Court of Appeals, Second Circuit, attempted to apply logically the "state classification" theory, the result was that the Union Guarantee & Mortgage Company (*In re Union Guarantee & Mortgage Company*, C. C. A. 2, 1935, 75 F. (2d) 984, 985) was held to be an insurance corporation ineligible for bankruptcy and reorganization because that company was organized under the insurance law of the State of New York, while the Prudence Company (*In re Prudence Co., Inc.*, 79 F. (2d)

77) was held to be neither an insurance company nor a banking company for the reason that it was not incorporated under the insurance laws and, though incorporated under the Banking Law, it was under the article of the Banking Law relating to investment companies rather than to banks, although the business of the Prudence Company was, for all practical purposes, identical with the business of the Union Guarantee and Mortgage Company. Of the business of the Union Guarantee and Mortgage Company in the opinion it was said: "* * * and its business was to make loans secured by mortgages on real property which it sold to its customers with a guaranty." Of the business of the Prudence Company in the opinion it was said: "* * * Its business has consisted in making mortgage loans on real estate and selling the mortgages to the public with its guaranty of payment."

With these decisions no doubt before the committees thereof, it is not surprising that the Congress, in enacting the Investment Company Act of 1940, did not adopt as the basis for classification in its definitions the so-called "state classification" rule.

Fidelity did not have charter powers to issue insurance contracts prior to December 31, 1940, and had never issued a single policy. Even after December 31, 1940, Fidelity did not have actual state authority to issue a single insurance policy (438). As another step in the abortive effort at voluntary extra-judicial reorganization, it sent to the holders of Series B Contracts, including Clause 6, the insurance feature, and received back, accepted by the contract holders, a number of offers to the contract holders to assume the insurance obligation carried by the Lincoln National Life Insurance Company incidental to some of Fidelity's annuity, face-amount certificate, contracts, at a time when Fidelity was not bona fide licensed to sell insurance contracts and when, and

after which time, in fact, the Lincoln National Life Insurance Company continued to carry the risks incidental to such annuity contracts. But Fidelity has not incurred a penny's liability under said insurance riders, so-called, it not appearing from the record that the Lincoln National Life Insurance Company is not fully solvent and able and willing to meet all of the obligations of its insurance contracts.

Fidelity has not, in fact, at any time engaged in the insurance business at all. Much less has insurance been at any time the principal business activity of Fidelity.

(4)

**The Charter Amendment of December 31, 1940, was Procured as One Step in an Abortive Effort to Effect a Voluntary, Extra-judicial Reorganization of Fidelity, and Neither the Procuring of the Charter Amendment nor the Doing of any Act Thereafter by Fidelity Transformed Fidelity into an Insurance Company Within the Meaning of the Term as Used in the Bankruptcy Act, as Defined in the Investment Company Act of 1940, or in Fact.**

Counsel for the respondents, other than the Securities and Exchange Commission, in filing briefs in opposition to the petition, divided the legal points among themselves (Brief, Edgar B. Sims, etc., et al., in opposition to petition, p. 4). Counsel to whom the particular point was assigned stated:

> "The Respondents do not contend that investment companies or face-amount certificate companies are excluded from the provisions of the Bankruptcy Act. *Likewise, the Respondents do not contend and the Circuit Court of Appeals did not hold that prior to December 31, 1940, the Debtor was an insurance company and not an investment*

*company or face-amount certificate company.* * * *"* (Italics ours.) (Brief, John B. Gontrum, etc., p. 9.)

*"* * * *We have made no claim and make none here that Fidelity was an insurance company prior to December 31, 1940."* (Italics ours.) Brief, Banking Commission of Wisconsin, et al., pp. 25-26.)

We do not know whether or not the same concession will be made by counsel for the respondents in the briefs upon the hearing in this Court, or in oral argument. Though the concession is but an inescapable conclusion, and a very proper one, it was not made in the Circuit Court.

The concession, if renewed, should also dispose of the contention previously made in the Circuit Court by counsel for the respondents and apparently accepted by the Circuit Court (255-256) that Fidelity was an insurance company for the reason that, under the statutes of West Virginia relating to life insurance companies (Code 33-3-7; Appendix) and under like statutes of many other states (see statutory references in footnote to Circuit Court Opinion (256)), life insurance companies are authorized to issue annuity contracts. This argument was that life insurance companies under the statutes of West Virginia and those of several other states were authorized to issue annuity contracts; Fidelity issued annuity contracts; Therefore, Fidelity was an insurance company.

The fallacy of such a contention is immediately apparent and was clearly exposed in the case of *Gamble* v. *Daniel*, C. C. A. 8, 1930, 39 F. (2d) 447, in which it was held that a trust company was not a banking corporation merely because it had many of the powers enjoyed and exercised by banking corporations. The corporation there considered, although it was invested with most of the

powers usually exercised by banking corporations, did not have the authority to receive deposits. So, in the case at bar, life insurance companies may issue annuity contracts and annuity companies of course may issue annuity contracts, but the fact that the annuity company may exercise that one power which the insurance company also has, does not mean that the annuity company is an insurance company when the annuity company does not have the really determinative power, the power to issue insurance contracts, the criterion of an insurance company.

So, if, as we believe we have demonstrated and as counsel for the respondents have heretofore conceded, Fidelity was not an insurance company prior to December 31, 1940, let us see what Fidelity has done on and after December 31, 1940, to be transformed into an insurance company.

Fidelity did procure a charter amendment on December 31, 1940, which would have authorized it to issue life insurance contracts, had it been able otherwise to qualify under the laws of the State of West Virginia and of other states as an insurance company (West Virginia Code 33-3-1; Appendix).

The West Virginia Auditor issued Fidelity a license as an insurance company from January 1, to April 1, 1941—it is said, in order to enable Fidelity to continue to receive installment payments upon its annuity contracts previously sold—*but upon the express condition, gentlemen's agreement, that Fidelity would not sell anything "until they got right" with the* Auditor's Office (227; 438).

Fidelity already had a license as an annuity company to receive such installment payments up to April 1, 1941 (West Virginia Code 33-9-1, 33-2-12; Appendix). This license was not canceled or revoked, except as limited by the so-called gentlemen's agreement, and, if the install-

ment payments were received by Fidelity under any license, it is more likely that they were received under the annuity company license already in effect than under the new insurance license which, in reality, was never effective.

Counsel for the respondents have contended, and no doubt will contend in this Court, that, after the effective date of the Investment Company Act, January 1, 1941, as an annuity company which had not qualified and could not qualify under the Investment Company Act, Fidelity could not legally receive through the United States mail such installment payments even on annuity contracts previously sold. If receiving through the mails such installment payments was illegal for Fidelity as an investment company, annuity company, its activities in this respect were not purged of their illegality by the mere procurement of the insurance company charter, because Fidelity could not become an insurance company under the Investment Company Act merely by amending its charter, but only in addition thereto by causing the issuance of insurance contracts to become its "primary and predominant business activity". Fidelity, in procuring from the West Virginia Auditor the license as an insurance company for the purpose of receiving such installment payments, had definitely agreed with the Auditor not to issue any insurance contracts (406; 438; 940-941).

Next, the respondents will insist, as they have heretofore done, that, in violation of the agreement with the West Virginia Auditor, Fidelity did write some 9,802 insurance contracts or reinsurance agreements to assume as many risks by sending out to the holders of Series B Contracts containing Paragraph 6, the insurance clause, some 14,626 in number, the letter and rider offering to assume the insurance responsibility which was carried

by the Lincoln National Life Insurance Company, 9,802 of such riders being returned to Fidelity accepted by the contract holders (237-238). But even then the tail would wag the dog. Such insurance, even if assumed by Fidelity, which it was not in fact, was but an optional feature incidental to the annuity contracts sold by Fidelity, the selling of which—certainly, prior to its purporting to assume the insurance obligations to the contract holders, in fact carried by the Lincoln National Life Insurance Company—was the sole business of Fidelity, and the servicing of which, after such purported assumption, was the only business activity of Fidelity. Even if it should be conceded *arguendo*, which we do not do, that, by attaching these riders to these 9,802 annuity contracts, Fidelity entered into the identical insurance obligations which the Lincoln National Life Insurance Company had undertaken, still such life insurance undertaking would be but incidental to Fidelity's own annuity contracts and a minor phase of Fidelity's business activities. Disregarding the other series of contracts issued by Fidelity, this rider was accepted by only 9,802 of the 14,626 holders of Series B Contracts containing the insurance provision (237-238), and, of the typical monthly payment of $7.50, only 25 or 50 cents, depending upon the age of the contract, was attributed to the insurance feature (683; 771). So long as the Lincoln National Life Insurance Company continued to carry the insurance—as it did, in fact—the purported assumption by Fidelity, if it had any legal effect at all, would be nothing more than "additional security" for the contract holders as was observed in *Bowers* v. *Lawyers Mortgage Company*, 285 U. S. 182, 189, with respect to the activities of the company there under consideration which procured title insurance from a title insurance company but guaranteeed the mortgage loans.

As a matter of fact, all of these things done on and after December 31, 1940, did not change Fidelity's busi-

ness activities or financial obligatons in the least. They were simply steps taken in an abortive attempt at voluntary extra-judicial reorganization (1188; 1087-1091; 941-943; 881; 895-896).

Fidelity could not continue as an investment company because of the Investment Company Act of 1940 (243; 866-867). An insurance company, as defined by the Investment Company Act, was exempt from the provisions thereof. Fidelity wanted to become such an insurance company. It was successful in the first step, the procurement by amendment of its charter of the charter powers to issue contracts of life insurance. Fidelity had no further success in its efforts to make the transition. It never did obtain the legal right to issue life insurance contracts. The license to operate as an insurance company issued to it by the West Virginia State Auditor was a pure sham. Fidelity had a writing purporting to be a license giving it the right to issue life insurance contracts, but the licensing authority, the West Virginia State Auditor, having the power to stop all of Fidelity's business activities—as, in fact, he did early in April, 1941—delivered the sham license to Fidelity only upon the condition and agreement that Fidelity would issue no insurance contracts and no new annuity contracts; and Fidelity accepted and agreed to the conditions (940-941).

Fidelity sent out and received back, accepted by many of the annuity contract holders, the rider to the annuity contracts by which it would have assumed the insurance obligations carried by the Lincoln National Life Insurance Company—when, if ever, Fidelity could clear with the West Virginia State Auditor and get the right to issue insurance contracts. That time never came. Fidelity continued to remit the insurance premiums to the Lincoln National Life Insurance Company, just as it had done before, and the Lincoln National Life Insurance Company

continued to carry the insurance risks, just as it had done before (230-232).

These annuity contract riders—contended by the respondents to be life insurance policies—issued by Fidelity were but an aftermath of the hearing of this case. Their existence was never presented to the District Court, presumably because they were recognized as having no legal or factual significance, but they were first presented in the Circuit Court by the West Virginia State Auditor in a petition for a remand of the case to the District Court. The petition for the remand was not acted upon by the Circuit Court, but, without further development of the circumstance other than the procurement of a stipulation by counsel that 9,802 of such riders had been returned to Fidelity accepted by the contract holders and the filing of an affidavit by the secretary of Fidelity that Fidelity had issued no insurance contracts, the Circuit Court found that:

> "In the meantime (between December 31, 1940, and April 1, 1941), however, the company (Fidelity) had issued a substantial number of policies of insurance in the following manner, without requiring payment from the insured. * * *" (Parentheses ours.)

and, after reciting the history of the riders, concluded the observation by saying:

> "* * * The company continued to pay the premiums on the group policy issued by the Lincoln National Life Insurance Company so as to continue it in force." (246).

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If these abortive attempts at voluntary extra-judicial reorganization changed the character of Fidelity and destroyed its eligibility for reorganization or bankruptcy,

then any corporation, without the knowledge of its creditors, may avoid, and deny to its creditors, bankruptcy, including the benefits of reorganization, by having its charter so amended as to give it insurance, banking, or building and loan association powers, and the corporation will be excluded from reorganization or bankruptcy not only if it never issues a policy, receives a deposit, or makes a loan, but even if it never receives unencumbered state authority to engage in such business activities. It is hardly possible that such could have been the intent of the Congress.

The effort at voluntary extra-judicial reorganization failed and it is respectfully submitted that the abortive effort did not alter the character of Fidelity as a corporation other than an insurance corporation as counsel for the respondents have conceded Fidelity to have been prior to that effort.

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## II. The Circuit Court Erred in Holding That the Petition of Fidelity, Filed Under Chapter X of the Bankruptcy Act, for Reorganization, Was Not Filed in Good Faith.

### (1)

### That Fidelity Had Assented To The West Virginia State Court Proceeding Did Not Preclude Fidelity From Filing Its Voluntary Petition For Reorganization Under Chapter X Of The Bankruptcy Act.

It is not disputed that Fidelity assented originally to the State Court proceeding.

No doubt, as matters have developed, it would have been wiser had Fidelity filed a petition under Chapter X prior to the effective date of the Investment Company Act

without making the futile effort to escape the operation of said Act by attempting to convert Fidelity into an insurance company, or, probably, failing in the effort to convert, to have resisted the proceeding in the West Virginia state court and to have immediately filed the petition in the District Court for reorganization.

However that may be, there was no great delay upon the part of Fidelity in recognizing the insufficiency and confusion of the many proceedings in the several state courts and the futility of relying upon the state court proceedings for reorganization (542). There were already differences of opinion between the West Virginia receivers and the Wisconsin receivers with respect to the objectives sought to be attained and the procedure therefor (412; 500). West Virginia has no reorganization statute (1206) and the West Virginia proceeding was no more than an equity receivership. It does not appear that any of the other state court proceedings were under reorganization statutes, if there are any such statutes in the other states concerned.

Even if the assent of Fidelity to the West Virginia state court proceedings were prompted by other than the most commendable motives, which we do not admit, the filing of the petition for reorganization in the District Court by Fidelity was not estopped. The controlling consideration is not the motive which impelled the filing of the petition, but is the interests of the creditors and stockholders and, in this case, it being apparent that all interests of the stockholders are gone, the creditors. Even though the officers of Fidelity may have lost their investments as stockholders, and Fidelity's assets may be less than its debts, yet Fidelity and its officers have a reponsibility to its creditors and a duty to take such action as may best subserve the interests of the creditors,

however many mistakes Fidelity and its officers may have previously made.

In the *Marine Harbor* case (1942, 87 L. ed. (adv.) 73, 76), the holding in the Rembaugh case (*Brooklyn Trust Co.* v. *Rembaugh*, C. C. A. 2, 110 F. (2d) 838) that a petition was not filed in good faith when the petitioner filed the same seeking to escape the jurisdiction of a state court to which it had voluntarily submitted its case, was disapproved; and it was held that the desire of the petitioner to escape the prior proceeding was immaterial and that the inquiry which Congress had prescribed by Section 146 (4), Chapter X, was whether "the interests of creditors and stockholders" would be better subserved by the prior proceeding or by the proceeding under Chapter X. In the *Marine Harbor* case it was found upon the particular facts there involved, the assets consisting of a single property and but one class of creditors being really interested, that the petition failed to show that the interests of the creditors and stockholders would be best subserved by the proceeding under Chapter X, but it was not because the petitioner had participated in the prior state court proceeding even though it was under the New York reorganization statute sometimes referred to as the Schackno Act.

The view of this Court in the *Marine Harbor* case presents a striking contrast to the estoppel doctrine which the Circuit Court would, at least by implication, apply to the case at bar in the observation that:

> "• • • Since the company deliberately assumed this new character to escape the requirements of the new federal and state statutes with respect to annuity companies, no weight should be given to the company's attempt to pose as an annuity company in the pending petition in bankruptcy. • • •" (255.)

If it appears from the record that the filing by Fidelity of the petition for reorganization will best subserve the interests of the creditors, the filing of the petition bespeaks good faith on the part of Fidelity and Fidelity's previous attitude towards reorganization under Chapter X or towards the state court proceeding is not material.

(2)

**The Record Not Only Does Not Show That "It Is Unreasonable To Expect That A Plan Of Reorganization Can Be Effected", But, To The Contrary, Does Show That It Is Quite Reasonable To Believe That A Plan Of Reorganization Can Be Effected.**

**Reorganization Under Chapter X Of The Bankruptcy Act Is Not Limited To, And Need Not Be, The Complete Rehabilitation Of Fidelity As A Going Concern.**

The scope of reorganization is very wide. It may include (1) "the sale or transfer of all or any part of its (debtor's) property to one or more other corporations theretofore organized or thereafter to be organized"; (2) "the merger or consolidation of the debtor with one or more other corporations"; or (3) "the sale of all or any part of its property, either subject to or free from any lien, at not less than a fair upset price and the distribution of all or any assets, or the proceeds derived from the sale thereof, among those having an interest therein". (Section 216(10), 11 U. S. C. A. 616(10).)

Obviously, and, as has been held in a number of cases* under this statute, as under 77B, reorganization is not lim-

*Slow, orderly, unified liquidation through another corporation. *In re Central Funding Company*, C. C. A. 2, 1935, 75 F. (2d) 256, 259. Group of stockholders eliminated. *In re Mortgage Securities Corporation*, C. C. A. 2, 1935, 75 F. (2d) 261. May be successor corporation. *Capital Endowment Company* v. *Kroeger*, C. C. A. 6, 1936, 86 F. (2d) 976, 979. Substitution of new debtor. *Continental Insurance Company* v. *Louisiana Oil Refining Corporation*, C. C. A. 5, 1937, 89 F. (2d) 333, 336. Not necessary that debtor present it-

ited to the full and complete rehabilitation of the debtor as a going concern, as the opinion of the Circuit Court of Appeals would seem to indicate to have been the only concept of reorganization entertained by that court (259).

In the Marine Harbor case in the Circuit Court of Appeals (1042, C. C. A. 2, 125 F. (2d) 296, 298), it was observed in the majority opinion:

> "* * * But even if it be unreasonable to expect that new money will be forthcoming or that any plan can be effected which will provide anything for the debtor or its shareholders, we do not think clause 3 of section 146, 11 U. S. C. A. Sec. 546 (3), requires dismissal of the debtor's petition; the reorganization may still go on in the interest of such creditors as shall be found entitled to share in the debtor's assets. * * *"

Judge Frank, agreeing with the majority opinion in this respect adds (p. 301):

> "The majority opinion recognizes that it is not at all necessary in order to avoid dismissal of a petition pursuant to Section 146 (3), to show that 'it is unreasonable to expect that a plan of reorganization be effected,' in which the debtor or its stockholders will participate. In the instant case, for instance, where, as the majority opinion states, the claims of the certificate-holders exhaust the debtor's property and no equity remains for the stockholders, there is no reason why (unless the stockholders furnish needed new money or other needed new consideration) a plan cannot be effected by

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self as a going concern proposing to continue as such. *R. L. Witters Associates* v. *Ebsary Gypsum Company*, C. C. A. 5, 1938, 93 F. (2d) 746, 746. Immediate sale of principal assets and ultimate liquidation of remaining assets by reorganized company. *In re Porto Rican American Tobacco Company*, C. C. A. 2, 1940, 112 F. (2d) 655, 657. See also *Old Fort Improvement Co.* v. *Lea*, C. C. A. 4, 1937, 89 F. (2d) 286.

which, without the expense or delay involved in foreclosure, the property will promptly be turned over to a new company, having no debts, all of the stock being ratably distributed among the certificate-holders. That some such plan can reasonably be expected to be effected under Chapter X is, we all agree, sufficient to prevent a dismissal pursuant to Clause (3)."

There is much testimony of qualified witnesses that in the opinion of such witnesses Fidelity can be reorganized.

The witness D. A. Burt, a man of wide business experience and connections (706), is of opinion that Fidelity can and should be reorganized. Upon an actuarily sound plan he believes that new capital might be available. The plan might embody insurance in whole or in part (706-710). The witness Hubert F. Young, whose business is that of supervising investments (630), believes that Fidelity could and should be reorganized. The reorganization might be effected through merger with another company having adequate capital or by the organizing of a mutual company, and the reorganized activities might include both annuities and insurance (630-633). The respondent and witness Edgar B. Sims, State Auditor and Ex-Officio Insurance Commissioner, who had supervised the activities of Fidelity for some eight years (434), thought there could be a reorganization under a mutual insurance company (457). H. Isaiah Smith, one of the respondent State Court Receivers, who also has given his full time to the affairs of Fidelity as an employee of the Trustee, is of opinion that Fidelity can be reorganized (479-480). Allen G. Messick, former chairman of the board of Fidelity, believes that there can be reorganization upon the basis of creating reserves consistent with the returns upon the securities available (544-545). The witness Raymond Latta, who has had experience in insurance

reorganization (1057-1058), says that it is possible to construct an actuarial plan of reorganization for Fidelity (1105) which might, if necessary, include a deferred liquidation (1123). Pell, Ltd., a financial organization, offered to buy the stock of Fidel, a subsidiary of Fidelity, and definitely expressed interest in Fidelity (1226). See also the testimony of Howard E. Reed (732-737).

There was and is much atmosphere or "color" about this proceeding substantiating the opinions expressed by these and other witnesses.

As has already been noted, the State Auditor who instituted the State Court proceeding and who, together with the receivers appointed in the State Court proceeding instituted by him (not depreciating the interests of the other respondents), may aptly be referred to as the principal respondents, was of the opinion that there could be reorganization and brought the suit for the purpose of rehabilitating and reorganizing Fidelity (457; 836; 1204). The State Auditor had even suggested the possibilities of resorting to "77B" (889; 1187). Counsel for the West Virginia receivers, among the principal respondents, states that he believes that there can be reorganization in the State Court (486; 624), but not in the Federal Court. In connection with this expressed view, it may be remembered that West Virginia has no reorganization statute and that reorganization in the State Court is necessarily limited to voluntary reorganization (1188; 1206), while the Federal Court has been invested by the Congress with jurisdiction to administer Chapter X, a very modern statute carefully drawn, after diligent study and research, for the very purpose of facilitating reorganization. The record shows many conferences among the Fidelity officers and representatives and by them with the State Auditor and with representatives of the Securities and Exchange Commission, all looking to reorgani-

zation (1190; 1087-1089; 1203; 895-896; 1155-1157). As was observed by the witness Risley, "Reorganization was the only thing that we were considering." "Reorganization is the only word that I heard mentioned in any of those conferences" (896). The possibilities of proceeding under Chapter X were considered (889; 950-952; 1184-1186) but resort was had to the State Court proceeding as a deliberate, though unwise, choice with full knowledge that the facilities of the reorganization court exercising jurisdiction under Chapter X might ultimately be necessary (704). The State Court receivers intended and were expected to present a plan of reorganization (689; 823-830).

Fidelity's aggregate assets amount to, in round figures, $21,100,000.00, or approximately ninety per cent (90%) of its aggregate liabilities, $23,476,000.00 (242; 196). The reserve funds of Income Reserve Contracts Series A, B, C, and D are solvent (1215; 632-633; 492-493; Ex. 21, 398). From 1934 until the end of 1940 the Series B Contracts represented a very large part of Fidelity's entire business (680; 685).

Upon the record the District Court concluded that Fidelity had met the burden of showing that it was not unreasonable to expect that a plan of reorganization might be effected.

The record shows very little with respect to the attitude of the creditors. The creditors have directly participated in the proceeding in only a most limited way. The only respondents who are creditors are L. H. Brooks, Trustee, Frederic Leake and A. L. Goldberg, Jr., Trustee. The other respondents are state officials, receivers or commissions. Though no point has been made thereof, it may be questioned whether they are persons who may controvert

the petition (11 U. S. C. A. 544). Until the creditors have knowledge of the possibilities of reorganization, it could hardly be expected that they would be able to formulate their own opinions upon the merits of reorganization or upon any particular plan.

Not to anticipate the discussion herein of 146 (4) but rather to suggest that this proceeding has not yet reached the stage where the attitude of the creditors has any particular significance, it may be recognized that to develop such information and present it to the creditors in a fair and impartial way is one of the very important features of Chapter X and one of the safeguards to creditors provided thereby. The indifference of individual creditors towards their own interests or their inability to present them was one of the principal reasons for the enactment of Chapter X, to rescue the creditors from complete reliance and dependency upon the information supplied and recommendations made by interested reorganization committees in the equity receivership proceedings, and to place upon the reorganization court under Chapter X the duty and responsibility of assembling full information and of presenting it to the creditors with sufficient fullness to enable the creditors to exercise an informed judgment. It is, therefore, not surprising that the creditors have not yet been active in this case. They cannot act intelligently until they are informed of their rights and interests.

Upon this record, can it be said that it is unreasonable to expect that some insurance or investment company can be found to take over or buy the assets of Fidelity under a contract for the benefit of the Fidelity contract holders, to issue them investment certificates or insurance policies, of one or more kinds of greater value than the dividends to such contract holders through the liquidation of Fidel-

ity would buy? Such an arrangement would afford the contract holders the benefit, in whole or in part, of the original selling costs of insurance policies or investment certificates which are, comparatively speaking, high and which will have been lost to the contract holders of Fidelity unless some plan of reorganization is effected (1103-1104). The purchaser of the assets might give the contract holders an option of taking in cash their determined equities in liquidation or of accepting an insurance policy or an investment contract which such equity would buy. A beneficial merger might be worked out with some other investment company or an insurance company. As suggested by the respondent West Virginia State Auditor (457), the organization of a mutual company to administer Fidelity's assets for the benefit of the contract holders is not beyond the realm of consideration. It should not be unreasonable to expect that at least the solvent funds or series of the Fidelity contracts might be reorganized and the solvent funds or series constitute a very material part of the assets and business of Fidelity (680). These observations are something more than a mere suggestion of remote possibilities. They are suggestions supported by the record and thoughts which should not be relegated to the realm of mere possibilities as distinguished from probabilities until there has been some opportunity to transform them into realities.

It is of course true that no plan of reorganization has yet been presented either to the Court or to the creditors, but it is also obvious that during all of this time, since the filing of the petition, when the basic jurisdiction of the District Court has been in controversy, no opportunity has been afforded for a determination of the rights and interests of the many classes of creditors, without which the formulation of a practical plan, for submission to the

Court and then to the creditors, would be a patent impossibility.

Just as valuation data, including debts and their classification, is necessary to enable the court to approve the plan, so also must the trustee have this information in a far-reaching and complicated case such as the case at bar in order to prepare a plan. Chapter X contemplates a full accounting as a condition precedent to the approval of the plan (*Consolidated Rock Products Co.* v. *du Bois*, 312 U. S. 510, 520, 523; 11 U. S. C. A. 575). Obviously this information could not be had prior to the determination of the basic jurisdiction of the reorganization court.

Necessarily good faith may be found in advance of the submission of a plan. Ordinarily jurisdictional good faith must be considered before the time for the presentation of any plan.

It is not believed that this case, long drawn out in the consideration of basic jurisdictional questions, had reached the stage of critical examination of plans of reorganization (*Continental Illinois Bank & Trust Company* v. *C. R. I. & P. R. Co.*, 294 U. S. 648, 685; *Chicago T. & T. Co.* v. *Forty-one thirty-six W. Corp.*, 1937, 302 U. S. 120, 133-134; *R. L. Witters* v. *Ebsary Gypsum Company*, 93 F. (2d) 746, 748; *In re Julius Roehrs Company*, C. C. A. 3, 1940, 115 F. (2d) 723, 724). The trustee should have an opportunity to explore the possibilities of reorganization, with assurances of the jurisdiction of the court by which appointed and, when there is no controversy with respect to the basic jurisdiction, with knowledge and after the determination of the broad principles by which the nature and extent of the claims of the many creditors are to be determined (*In re Marine Harbor Properties*, C. C. A. 2, 1942, 125 F. (2d) 296, 298).

The foregoing observations have been made from the point of view of a reorganization by merger, or by the sale of assets to some other corporation with a contract by the purchaser to pay in cash or by an insurance or annuity contract the full value of the various claims of the creditors of Fidelity as determined by the value of the assets of Fidelity in which the several classes of creditors may participate, as ascertained in this proceeding, or by the organization of a new mutual corporation entirely for the benefit of the creditors, or some such practical device. But, as a last resort, even a slow, orderly, unified, beneficial liquidation, which we do not believe to be inevitable in this case, is within the scope of reorganization and would certainly seem to be more practicable and more beneficial to the creditors than the divergent liquidations and distributions in the distinct and separate state proceedings as hereinafter discussed (*In re Central Funding Corporation, supra; In re Mortgage Securities Corporation, supra; R. L. Witters Associates* v. *Ebsary Gypsum Company, supra; In re Porto Rican American Tobacco Company, supra;* Bankruptcy Act, Chapter X, Sec. 216 (10); 11 U. S. C. A. 616 (10)). The District Court was well within its proper powers and jurisdiction in considering this as a possibility of reorganization in the last resort, in the event more desirable plans of reorganization for any reason should not materialize or should not be approved by the creditors.

The District Court had much upon which to base its conclusion that it was not unreasonable to expect that a plan of reorganization could be effected, and its finding in this respect should not have been reversed by the Circuit Court of Appeals. (*In re Mount Forest Fur Farms of America,* C. C. A. 6, 1939, 103 F. (2d) 69, 71, Cert. Den. 308 U. S. 583; *In re Equity Company,* 115 F. (2d) 570, 572-3.)

(3)

**The Assets Of Fidelity Are Physically Located In Many States. Already There Are Pending Twelve Separate Proceedings In The Courts Of As Many States. None Of The State Proceedings Is Under a State Reorganization Statute, And There Is No Prior Proceeding Pending In Which The Interests Of The Creditors Are Provided The Safeguards Afforded By Chapter X Or In Which The Interests Of Creditors Would Be Best Subserved.**

Securities of Fidelity have been deposited in fifteen states and yet remain there. Twelve distinct proceedings have been brought in as many states (246). Should this proceeding be dismissed it is likely that there will be three more such suits in courts of additional states.

The first suit was brought in the West Virginia State Court and the suits in the other states shortly followed. Differences of opinion between the West Virginia court receivers and the Wisconsin officials with respect to the management and disposition of the assets held in Wisconsin arose immediately (500; 542).

There is no single prior proceeding having jurisdiction over any of the assets of Fidelity other than those found within the borders of the particular state in which the proceeding was instituted or over all of the creditors of Fidelity. These proceedings in the several state courts are not under any reorganization statute and, apart from the want of jurisdiction of any particular proceeding over either the property of Fidelity generally or the persons interested in the subject matter, any reorganization which might be hoped for through the State Court proceeding could be only by voluntary agreement (1206; 1100-1101; 1188).

The West Virginia State Court proceeding is only a

proceeding in the nature of an equity receivership. The proceedings in the other states are equivalents thereof.

Section 77B was enacted to supply deficiencies in the old equity receivership proceedings and, later, Chapter X was enacted to supply deficiencies in both the old equity receivership proceedings and in the proceedings under Section 77B. One of the most striking of such deficiencies was the absence of any provision to inform fully the creditors and stockholders in order that they might intelligently consider the propos'ls of the corporate or reorganization management which of course had superior knowledge and occupied advantageous positions. In other words, Chapter X was designed to provide safeguards for the creditors and stockholders against the superior knowledge and advantageous position of the management.

In the *Marine Harbor* case, involving only one property and only one class of creditors really interested, the problem was a simple one, not necessitating the safeguards provided by Chapter X. However, the opinion in the *Marine Harbor* case clearly recognized the superiority of the Chapter X proceeding when the affairs of a corporation might be complicated. In the opinion it was observed

> "• • • And it is asserted that comparable safeguards are wholly or largely lacking in proceedings under the Schackno Act. Those considerations would be highly relevant and persuasive if this was a case of the usual reorganization proceeding dealing with more than one class of securities under the older procedures which chap. X was designed to improve and supplant. See Securities & Exch. Commission v. United States Realty & Improv. Co., supra (310 US p. 448, 84 L. ed. 1299, 60 S. Ct. 1044, 42 Am. Bankr. Rep. (NS) 602) H.

Rep. No. 1409, 75th Cong. 1st Sess. pp. 37 et seq. Then the safeguards afforded by chap. X would have special significance in protecting the respective classes of investors against improvident, unfair or inequitable adjustments, compromises, and settlements—steps which are basic to the reorganization process but which in selfish hands led to much abuse. * * *" (*Marine Harbor Properties, Inc.* v. *Manufacturer's Trust Co.*, 87 L. ed. (Adv.) 73, 77).

The opinion in the case of *Securities & Exchange Commission* v. *United States Realty & Improvement Co.*, 1939, 310 U. S. 434, 448-450, presents the importance of the various safeguards of Chapter X.

The insufficiencies of the equity receivership proceedings are pointed out and the safeguards of Chapter X are considered and discussed by Judge Frank in his dissenting opinion in the *Marine Harbor* case, while that case was in the Circuit Court of Appeals (*In re Marine Harbor Properties, Inc.*, 1942, 125 F. (2d) 296, 302-306).

Among other factors of the Chapter X proceeding which enable proceedings thereunder to better subserve the interests of creditors are: the advisory reports of the Securities & Exchange Commission on the feasibility of the plan, as well as upon the question of whether or not the plan is fair and equitable; the report to creditors under Section 175, showing the creditors' interests and the value thereof, the creditors otherwise having no independent means of obtaining impartial information and advice; the independent study by the Securities & Exchange Commission and the examination by the court exclude collusive programs; the plan to be submitted to the creditors must be approved by the court prior to the submission to the creditors, which eliminates the reluctance which the

court might otherwise have about rejecting a plan after much work had been done to secure its approval; the independent appraisal of the assets of the debtor's estate by the Securities and Exchange Commission, an expert and disinterested agency, is of indispensable value to the proceeding—the importance of such an independent appraisal is fully shown in *First National Bank of Cincinnati* v. *Flershem*, 1934, 290 U. S. 504; the reorganization court has jurisdiction to retain supervision for the purpose of seeing that the plan is fully and fairly carried out.

No single one of the state courts is in a jurisdictional position to review all of the liabilities of Fidelity or to appraise its assets in order to give the creditors the information required by Section 175 of Chapter X. It does not appear that the state courts have the services of experts provided by the Securities and Exchange Commission.

It should be borne in mind that these various provisions or safeguards were adopted after long study by the Securities and Exchange Commission and were based upon the experiences of the equity receiverships and the proceedings under Section 77B and the needs demonstrated thereby.

If these safeguards do not better subserve the interests of creditors than do the procedures in the ordinary equity receiverships, then the work of Congress in causing the problems and necessities to be studied and in enacting Chapter X has been largely in vain. And if the Congress meant by Section 146(4) that the old equity receivership, from the standpoint of good faith, subserved the interests of creditors in a complicated and far-reaching case just as well as does the proceeding under Chapter X, then

Congress impliedly recognized the futility of its own work.

To the contrary, Congress expressly provided by Section 256 that the petition for reorganization under Chapter X might be filed and approved notwithstanding the pendency of prior proceedings, thus recognizing that many such prior proceedings would likely be insufficient or inefficient as compared with the procedure as provided by said Chapter X, recognizing also that resort might have been had to prior proceedings collusively for the very purpose of avoiding or escaping the requirements of Chapter X for the protection of creditors (Judge Frank in the *Marine Harbor* case, 125 F. (2d) 296, 306) (1094; 1103-1105).

It is not a sufficient answer for the respondents to say that they will voluntarily do all of these things in the several state court proceedings which Chapter X requires to be done in the reorganization proceeding. In the first place, no one of the state courts has the territorial jurisdiction over the subject matter and persons to do these things in behalf of all the creditors. The Congress has found it to be necessary to provide these safeguards as statutory procedural requirements, having found the voluntary inclinations to do these things, in the absence of statute, to be insufficient for the protection of creditors scattered throughout the land and individually holding several claims ordinarily of the size not sufficient to sustain individual participation in the widely dispersed litigation sufficient to protect the interests of the individual creditors, even assuming, which would probably be contrary to the fact, that a few interested and active creditors would be able, in the face of the inaction of thousands of others relying upon the management, to protect even their own interests.

It may also be recalled that the Congress has declared particularly that the business of investment companies, face-amount certificate companies, meaning the business of Fidelity, is affected with a national public interest, strongly suggesting that such a business can be effectively administered only by a court having national jurisdiction, which national jurisdiction has been invested in the bankruptcy court by Section 111 of Chapter X (11 U. S. C. A. 511).

Could it be that the Congress intended by Section 146(4) that the interests of the creditors of a business affected with a national public interest, actually extending into twenty-nine states, would be subserved better by the administration by twelve distinct state courts of limited territorial jurisdiction than by a single national court having national jurisdiction including jurisdicton of all property involved and all persons concerned?

If Congress contemplated that the interests of such creditors would be best subserved by the several state proceedings conducted without the statutory safeguards found to be necessary by the Congress, then Congress did not accomplish much by providing the statutory safeguards or by conferring upon the national courts full jurisdiction to administer them.

If voluntary reorganization through the state proceedings be relied upon, it is obvious that the creditors—many individuals having relatively small separate claims—will be at the mercy of those having charge, so to speak, of the several state court proceedings, one of the shortcomings of the old equity receivership for the elimination of which Chapter X was adopted.

None of the state court proceedings is under a statute which requires that the plan of reorganiaztion be sub-

mitted to the creditors only after it has been approved by the court, as is provided by Chapter X. None of these state proceedings is under a statute having provisions comparable to those of Chapter X for participation and guidance by an informed statutory agency such as the Securities and Exchange Commission.

At this time we are concerned only with jurisdictional questions and not with the relative rights and equities of the various creditors of Fidelity. However, since whether the jurisdiction of the District Court or the several jurisdictions of the state courts will best subserve the interests of creditors is a jurisdictional matter as related to good faith, it would seem to be not inappropriate to observe that there are some real questions which sooner or later will have to be resolved by some court with respect to the relative rights and interests of the various creditors and classes of creditors.

It is a real question whether any or all, and, if not all, which ones of the several series of contracts have resulted in the creation of trusts in particular assets for the benefit of the creditors whose payments have been invested therein. If any one or more of the series of contracts has resulted in the creation of a trust for the benefit of the contract holders whose payments have been invested in particular assets, there is then the question whether these assets may be followed and impressed with the trust in the hands of the state officials with whom such assets have been deposited (606-607; 611-612; 635-649; 653-655; 1072; 1179).

It is obvious that these questions must be finally resolved before the various creditors and classes of creditors can know what their interests in the assets of Fidel-

ity are and the value thereof. Certainly these questions must be finally resolved before there is any distribution of the assets of Fidelity.

The several state representatives, as well as the Tennessee creditors as represented by L. H. Brooks, Trustee, Frederic Leake and A. L. Goldberg, Jr., Trustee, apparently have proceeded upon the assumption that the several state deposits were made from free assets of Fidelity and should be applied upon the claims of the various creditors resident in the respective states (52; 94; 99-100) and, without regard for the claim that when such securities were deposited in such states, such securities were already, by the terms of such annuity contracts, held by Fidelity in trust for the holders of annuity contracts of the particular series, without regard for state lines, and under circumstances which might charge the state officials with knowledge of the trusts to which the securities accepted by them were subject (654-655).

The several state court proceedings at least threaten distribution of the assets held by the several states without the judicial determination of the possible rights and interests of the out-of-state creditors having interests or rights to participate in such assets. Obviously, these rights and interests must be determined before there can be any proper distribution of the assets and Chapter X (Sections 196 and 197) requires such ascertainment promptly after the petition is approved.

The question of the right of the contract holders to improve their contracts is also an important one. A contract does not have a surrender value until a substantial number of installments have been paid thereon (684). Do the contract holders who were not in default but who had not made sufficient installment payments to give their

contracts a surrender value have the right to continue the payments and thus bring about a surrender value (1261-1262)? This question also should be definitely determined before there is any distribution of the assets of Fidelity.

There is a substantial surplus of assets in Wisconsin, and there appear to be small surpluses in Delaware, Iowa, Missouri, and Alabama. Can it be that the interests of the creditors are best subserved by imposing upon them the responsibility of presenting their claims in the courts of many states in order to preserve their rights to participate in the distribution of all of the assets of Fidelity in which they are legally entitled to participate, however great or small the particular group of assets may be?

We believe, rather, that the very purposes of the Investment Company Act, and of the amendments thereof to the Bankruptcy Act, and of Chapter X were to avoid any such confusion and futility.

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The Circuit Court seemed to be of opinion that the interests of the creditors would be best subserved because many questions of state law will likely arise and may be better determined by state courts. But questions under the laws of many other states also will arise in the courts of the several states. It would seem that the courts of one state would be in no better position to determine the laws of other states than is a federal court to determine the laws of the several states. Federal courts have always been required to consider state laws and there is no reason to believe that the District Court will not respect the laws of the several states involved when they become of importance in this proceeding.

The Circuit Court, following the case *In re Union Guarantee and Mortgage Co.*, 75 F. (2d) 984, accepted and approved the philosophy that "* * * Congress in ex-

cepting from the Bankruptcy Act those corporations, such as insurance, railroad and banking corporations, whose business during their active life and whose liquidation in case of insolvency are strictly regulated by State law. * * *" (262) manifested an intent to abandon such corporations, so to speak, because of the alleged conceded superiority of state supervision in these respects. If such ever were the Congressional policy, and it may have been at some earlier day, that Congressional policy was most certainly changed, in so far as face-amount certificate companies are concerned, by the enactment of the Investment Company Act of 1940, which found and declared that the activities of investment companies, including face-amount certificate companies, were affected with a national public interest and provided for their supervision and regulation by a federal agency, the Securities and Exchange Commission, during life, and also made available for their administration, upon their demise, the bankruptcy courts, with Securities and Exchange Commission participation.

In the *Marine Harbor* case the property was located in only one state and there was only one class of creditors that could, by any possibility, participate in the assets of the debtor. The proceedings in the case at bar involve assets in many states and creditors, obviously, of many classifications as holders of the several series of contracts issued by Fidelity and questions with respect to the assets in which the various classes of creditors are entitled to participate.

The situation in the case at bar is more like that considered by United States District Judge Bryant in the *National Surety Company* case (*In re National Surety Company*, 7 Fed. Supp. 959, 961), with respect to which the following observation in the opinion is convincing:

"It is with regret that I refuse to take jurisdiction. I say this because it is apparent that future administration could be more readily carried on under one control than under the limited jurisdiction of several state courts. It seems almost a travesty to have to deny to this company the benefits of sections 77A and 77B of the Bankruptcy Act while its principal subsidiary is being administered thereunder. However, to hold differently would be the taking of powers that Congress did not deem it wise to give."

The jurisdiction which Judge Bryant considered to be so needed in the *National Surety Company* case exists in the case at bar and its appropriateness and superior suitability is clear.

If there ever has been or ever will be a case in which a single court of competent jurisdiction is needed to take charge of the diverse and complicated affairs of a debtor corporation for the purposes of reorganization, even if that reorganization be no more than an orderly liquidation, we believe it is the case at bar; and, we further believe that Chapter X of the Bankruptcy Act and the Investment Company Act of 1940 were tailor made, so to speak, to meet this situation, and that this is not a factual situation with respect to which there could possibly be a prior state court proceeding which would best subserve the interests of the creditors.

## CONCLUSION

For the reasons aforesaid, it is urged that Fidelity is not an insurance company, that the voluntary petition of Fidelity for reorganization under Chapter X was filed in good faith, that the order of the United States

Circuit Court of Appeals for the Fourth Circuit should be reversed, and that the order of the United States District Court for the Southern District of West Virginia should be affirmed.

Respectfully submitted,

JAMES R. FLEMING,
JOHN V. RAY,
HOMER A. HOLT,
*Counsel for Fidelity Assurance Association, Debtor.*

T. C. TOWNSEND,
HILLIS TOWNSEND,
*Counsel for Central Trust Company, Trustee for Fidelity Assurance Association.*

Charleston, West Virginia,
January 9, 1943.

# APPENDIX

## FEDERAL STATUTES

### Bankruptcy Act

CHAPTER III

Section 4, (11 U. S. C. A. 22):

(a) Any person, except a municipal, railroad, insurance or banking corporation or a building and loan association, shall be entitled to the benefits of this Act as a voluntary bankrupt.

(b) Any natural person, except a wage earner or farmer, and any moneyed, business, or commercial corporation, except a building and loan association, a municipal, railroad, insurance or banking corporation, owing debts to the amount of $1,000 or over, may be adjudged an involuntary bankrupt upon default or an impartial trial and shall be subject to the provisions and entitled to the benefits of this Act. • • •

CHAPTER X

Section 106(3), (11 U. S. C. A. 506):

For the purposes of this chapter, unless inconsistent with the context—

(3) "corporations" shall mean a corporation, as defined in this Act, which could be adjudged a bankrupt under this Act, and any railroad corporation excepting a railroad corporation authorized to file a petition under Section 77 of this Act.

Section 144, (11 U. S. C. A. 544):

If an answer filed by any creditor, indenture trustee, or stockholder shall controvert any of the material allegations of the petition, the judge shall, as soon as may be, determine, without the intervention of a jury, the issues presented by the pleadings and enter an order approving the petition, if satisfied that it complies with the requirements of this chapter and has been filed in good faith and that the material allegations are sustained by the proofs, or dismissing it if not so satisfied.

Section 146, (11 U. S. C. A. 546):

Without limiting the generality of the meaning of the term "good faith," a petition shall be deemed not to be filed in good faith if—

(1) • • •

(2) • • •

(3) it is unreasonable to expect that a plan of reorganization can be effected: or

(4) a prior proceeding is pending in any court and it appears that the interests of creditors and stockholders would be best subserved in such prior proceeding.

Section 216(10), (11 U. S. C. A. 616(10)):

A plan of reorganization under this chapter—(10) shall provide adequate means for the execution of the plan, which may include: the retention by the debtor of all or any part of its property; the sale or transfer of all or any part of its property to one or more other corporations theretofore organized or thereafter to be organized; the merger or consolidation of the debtor with one or more other corporations; the sale of all or any part of its property, either subject to or free from any lien, at not less

than a fair upset price and the distribution of all or any assets, or the proceeds derived from the sale thereof, among those having an interest therein; the satisfaction or modification of liens; the cancelation or modification of indentures or of other similar instruments; the curing or waiver of defaults; the extension of maturity dates and changes in interest rates and other terms of outstanding securities; the amendment of the charter of the debtor; the issuance of securities of the debtor or such other corporations for cash, for property, in exchange for existing securities, in satisfaction of claims or stock or for other appropriate purposes.

## Investment Company Act of 1940

### Title I

Section 29(a), (11 U. S. C. A. 107 (f)):

Sec. 29. (a) Section 67 of an Act entitled "An Act to establish a uniform system of bankruptcy throughout the United States", approved July 1, 1898, as amended, is amended by adding at the end the following:

"f. (1) For the purposes of, and exclusively applicable to, this subdivision f (a) 'debtor' shall mean a face-amount certificate company as defined in section 4 of the Investment Company Act of 1940; (b) 'face-amount certificate' shall mean a face-amount certificate as defined in section 2 of the Investment Company Act of 1940; (c) 'depositary' is a person or State agency with whom securities or other property of a debtor is deposited or to whom property of a debtor is transferred, in trust or otherwise, pursuant to the requirements of a State law or an agreement by the debtor providing for the distribution of such property or its proceeds to creditors or security holders of the debtor in the event of the insolvency of the debtor or under other specified circumstances;

(d) 'deposit creditor' is a creditor who, under the provisions of a State law or agreement providing for a deposit with or transfer to a depositary, has rights as to the securities or property so deposited or transferred which exceed the rights of a general creditor; and (e) 'State agency' is an official or agency of a State designated to act as depositary or to distribute property, or the proceeds of property held by a depositary.

"(2) Every deposit or transfer of securities or other property made by or on behalf of a debtor with or to any depositary for the benefit or protection of or to secure the holder of any security sold by or on behalf of the debtor on or after January 1, 1941, shall be voidable as against the trustee of such debtor if the property of the estate is insufficient for the full payment and discharge of all claims on account of all face-amount certificates sold by or on behalf of the debtor, and such deposit or transfer and every lien created thereby shall thereupon be avoided by the trustee subject to the provisions of paragraph 3 of this subdivision f.

"(3) In the event any deposit or transfer described in paragraph 2 of this subdivision f shall be avoided the trustee shall segregate the property received by the trustee from the depositary and charge the same with the costs and expenses of maintenance and liquidation and distribute the net proceeds thereof to the creditors who would have been entitled thereto under the provisions of the law or agreement providing for the deposit or transfer of the property, and each such creditor shall thereafter be entitled to dividends from the estate only after all creditors of the same rank shall have received the same percentage.

"(4) The court shall have summary jurisdiction of any proceedings to hear and determine the rights of any

parties under this subdivision f and to hear and determine the sufficiency of the property of the estate for the full payment and discharge of all claims on account of all face-amount certificates sold by or on behalf of the debtor. Due notice of any hearing in such proceedings shall be given to every depositary and State agency which is a party in interest.

"(5) Where the provisions of subsection (c) of section 28 are not applicable, the provisions of this section will not apply."

Section 3(c3 (3) and (6), (15 U. S. C. A. 80-a-3 (c) (3) and (6)):

Notwithstanding subsections (a) and (b), none of the following persons is an investment company within the meaning of this title:

(3) Any bank or insurance company; any savings and loan association, building and loan association, co-operative bank, homestead association, or similar institution, or any receiver, conservator, liquidator, liquidating agent, or similar official or person thereof or therefor; * * *.

(6) Any person who is not engaged in the business of issuing face-amount certificates of the installment type or periodic payment plan certificates, and who is primarily engaged in one or more of the following businesses: (A) Purchasing or otherwise acquiring notes, drafts, acceptances, open accounts receivable, and other obligations representing part or all of the sales price of merchandise, insurance, and services; (B) making loans to manufacturers, wholesalers, and retailers of, and to prospective purchasers of, specified merchandise, insurance, and services; and (C) purchasing or otherwise acquiring mortgages and other liens on and interests in real estate.

Section 25(d) (15 U. S. C. A. 80a-25(d)):

(d) Nothing contained in this section shall in any way affect or derogate from the powers of the courts of the United States and the Commission with reference to reorganizations contained in the Bankruptcy Act of 1898, as amended.

## STATUTES OF WEST VIRGINIA

### Michie's 1937 Code

Chapter 33, entitled "Insurance and Annuity Contracts"

Article 2, entitled "General Provisions"

Section 5. Issuance of License by Insurance Commissioner.—Upon receiving such certified copy and statement, the insurance commissioner may examine such company or association, and if he finds that it has complied with the terms of its charter or articles of association and the laws of this State, and with all the provisions in other sections of this chapter prescribing conditions precedent to the issuance of a license, or certificate of authority, and is satisfied that it is solvent (or if chartered or organized under the laws of any foreign country, is solvent in the United States), he may issue to it a license, or certificate of authority, stating such facts and authorizing it to issue policies, make contracts of insurance, and transact business in this State.

Section 12. Time Licenses Shall Continue in Force.—All licenses, or certificates of authority issued by the insurance commissioner to insurance companies or associations, or agents, solicitors or brokers, shall continue in force until the first day of April next following their issuance, unless the same be sooner revoked.

Section 45. Proceedings in Circuit Court of Kanawha County against Insolvent Company.—Whenever any company under the supervision and regulation of the insurance commissioner shall become insolvent or shall be in such financial condition as not to be able to pay its creditors in this State, the commissioner of insurance may file a bill in the circuit court of Kanawha county for the administering of the assets of such company as an insolvent, and for the purpose of taking possession of its property in this State and the distribution of its assets among those entitled thereto according to their respective right.

Article 3, entitled "Life Insurance"

Section 1. Capital of Life Insurance Companies.—No life insurance company shall be admitted to do business in this State, or shall, directly or indirectly, enter into contracts of insurance, issue policies, take risks or transact business in this State, unless it has at least two hundred thousand dollars cash capital fully paid up or a like amount of cash surplus, securely invested: Provided, That this section shall not apply to fraternal benefit societies organized in pursuance of the provisions of article eight of this chapter.

Section 7. Annuities May Be Issued by Life Companies.—Life insurance companies chartered by and doing business in this State, and empowered to make contracts contingent upon life, may grant and issue annuities, either in connection with or separate from contracts of insurance based upon life risks, and all such annuities heretofore issued by such companies shall be valid.

Article 9, entitled "Annuity Contracts"

Section 1. License from Insurance Commissioner Prerequisite to Engaging in Business.—No person, associa-

tion or corporation shall engage in the business of soliciting or receiving deposits or payments on any annuity contract or certificate or annuity bond in fixed and stipulated installments, within this State, without first having obtained from the insurance commissioner a license to do business in this State: Provided, however, That this article shall not be construed as applying to persons, associations or corporations engaged in selling merchandise in installments, insurance companies, foreign or domestic, duly authorized to do business in this State, building and loan associations, national banks and banking institutions organized and authorized to do business under the laws of this State, fraternal insurance societies, or surety companies doing business under the laws of this State. Such license shall be issued for one year, or the fractional part of a year, and for issuing the same a fee of ten dollars shall be charged; and the provisions of section twelve, article two of this chapter shall apply to such license.

Section 2. License Prerequisite to Negotiating Contracts.—No person, association or corporation shall sell or offer for sale or deliver within this State any contract, certificate or bond of any person, association or corporation required by this article to obtain a license from the insurance commissioner to transact business in this State until such license has been issued by said insurance commissioner.

Section 3. Deposits to be Made with the Treasurer.—Before a license to transact business in this State shall be issued by the insurance commissioner to any person, association, or corporation, within the purview of section one of this article, the insurance commissioner shall require the applicant to deposit with the state treasurer (in accordance with article five, chapter twelve of this code), in trust, for the benefit of its contract holders, bonds of

the state of West Virginia, or such other bonds, and securities including bonds issued by the West Virginia bridge commission as may be approved by said insurance commissioner, or both, to the aggregate amount of one hundred thousand dollars, and, in addition to such deposit, such person, association or corporation shall maintain at all times a deposit with the state treasurer of bonds and securities approved by the insurance commissioner to an amount equal to the total amount which such person, association or corporation may be liable to pay in cash to the holders of all contracts under the terms thereof at the time of the deposit: Provided, That when, by the laws of any other state, any such person, association or corporation shall have been required to make and shall have made such deposit in such state, equal or greater in amount for the benefit of contract holders in such state, upon the filing of a certificate to such effect from the proper officer in such state with the insurance commissioner of this State, such person, association or corporation shall not be required to make such deposit with the treasurer of this State for the benefit of its contract holders in such other state; and when the laws of any other state require such deposit less in amount, such person, association or corporation shall file a certificate from the proper officer in such state with the insurance commissioner of this state showing the amount of the deposit made, and shall deposit with the treasurer of this state an amount which, together with the deposit made in such other state, shall make up the total amount required by this state to be deposited by such person, association or corporation, and such contract holders in such other state shall not be entitled to the benefit of the securities deposited with the treasurer of this State under this article, except so much of such deposit as may be made to complete the total amount required by this article where the law of any other state requires a lesser amount.

The insurance commissioner may require an independent appraisal, at the expense of the company, of any property on which it holds a mortgage or trust deed or any bond or other investment offered by such company for the purpose of complying with the deposit provisions of this article.

Section 5. Revocation of License on Failure to Make Additional Deposits or Insufficiency of Assets.—On the failure of such person, association or corporation to deposit such additional bonds and securities with the state treasurer when so required by the insurance commissioner, the license to do business in this State shall be revoked by the insurance commissioner. Whenever the insurance commissioner, upon an examination of the affairs of any such person, association or corporation, finds that the liabilities of such person, association or corporation exceed the assets thereof, the insurance commissioner shall suspend the license of such person, association or corporation until he is satisfied that the assets of such person, association or corporation are increased to exceed said liabilities.

Section 10. Authority of Insurance Commissioner; Control of Deposit Where License Revoked.—The insurance commissioner shall have the same authority over every person, association, or corporation engaged in selling annuity contracts, certificates, or bonds, as over insurance companies, and if in his opinion the assets are impaired or such person, association or corporation is not complying with the law, said commissioner shall have authority to revoke the license of such person, association, or corporation to do business in this State, and, if such license is so revoked, the deposit or a sufficient amount of same, shall remain under the authority and control of the insurance commissioner until the total liability of all the contracts, certificates or annuity bonds or contracts issued

by such person, association or corporation in this State is redeemed or settled.

Chapter 46, Acts of 1941 (Michie's 1941 Cumulative Supplement to the West Virginia Code of 1937, Chapter 32, entitled "Speculative Securities and Fraudulent Sales", Article 3, entitled "Registration and Sale of Face-Amount Certificates")

Section 1. Definitions.—For the purposes of this article the term "face-amount certificate" shall mean any certificate, investment contract, or other security which represents an obligation on the part of its issuer to pay a stated or determinable sum or sums at a fixed or determinable date or dates more than twenty-four months after the date of issuance in consideration of the payment of periodic installments of a stated or determinable amount; or any security which represents a similar obligation on the part of its issuer, the consideration for which is the payment of a single lump sum.

All other terms used herein shall have their respective meanings, as provided in section two, article one of this chapter.

Section 2. When Certificates Exempt from Registration. — Face-amount certificates issued by a person licensed and supervised by the insurance commissioner of this state shall be exempt from registration under the provisions of this article.

Section 3. Restriction on Sale.—No face-amount certificates, except those exempt under the provisions of section two hereof, shall be sold within this state unless such face-amount securities shall have been registered as hereinafter provided.

Section 4. Registration of Certificates.—Face-amount certificates shall be registered hereunder by the filing of

an application with the commissioner by the issuer or by any dealer properly registered under the provisions of section twelve, article one of this chapter: Provided, That the issuer of such certificates is registered under the provisions of an act of Congress entitled "Investment Company Act of 1940." Such application is to be in the form prescribed by the commissioner. With each such application there shall be filed a certified copy of the registration statement which was filed by the issuer of such certificates with the securities and exchange commission pursuant to the provisions of section eight of the said "Investment Company Act of 1940."

The commissioner may require that the applicant file with him such additional data and information respecting the issuer as he shall deem necessary and pertinent to registration hereunder.

The commissioner shall have power and authority to place such conditions, limitations and restrictions on any registration as may be necessary to carry out the purposes of this article.

Section 5. Fees for Registration.—At the time of filing the application mentioned in section four of this article, the applicant shall pay to the commissioner a fee of one-twentieth of one per cent. of the aggregate face-amount of the certificates to be sold in this state for which the applicant is seeking registration, but in no case shall such fee be less than twenty-five dollars, nor more than three hundred dollars.

Section 6. Expiration of Registration; Reregistration.—Every registration under this article shall expire on the thirtieth day of June in each year. New registrations for the succeeding year shall be issued upon written application, the applicant furnishing the commissioner, upon request, information as hereinbefore provided, and pay-

ing the commissioner a fee on the basis specified in section five of this article on the aggregate face-amount of the certificates to be sold in this state within the year to be authorized by registration. Applications for renewal registration must be made not less than thirty days before the first day of the ensuing registration year, otherwise they shall be treated as original applications.

Section 7. Nonresident Issuer to File with Application for Registration Written Appointment of State Auditor as Attorney in Fact; Service and Acceptance of Process.—When any issuer of face-amount certificates shall not be domiciled in this state, he shall file with every application for registration hereunder (whether such application be made by the issuer in person or by or through a registered dealer) his irrevocable written appointment of the state auditor, or his successor in office, to be his true and lawful attorney in fact, who may accept or upon whom may be served, any lawful process or pleading in any action or proceeding against him in any court of record in this state, and such filing shall constitute his consent that any such process or pleading against him, which is properly served upon the state auditor or is accepted by the state auditor, shall be of the same legal force and validity as process or pleading duly served upon said issuer in this state. In case any process or pleading is served upon the state auditor, or accepted by him, such service shall be made in duplicate, one copy of which shall be filed in the office of the state auditor and the other immediately forwarded by registered mail to the principal office of the issuer against whom such process or pleading is directed.

Section 8. Sales to Be Made Only by Registered Dealers.—Face-amount certificates shall be offered for sale and sold in this state only by dealers and salesmen regis-

tered with the commissioner under the provisions of section twelve, article one of this chapter.

Section 9. Violations; Penalties.—Any person subject to the provisions of this article, who shall sell or offer for sale any face-amount certificates within this state without complying with the provisions of this article, or who continues to sell or offer for sale any such certificates after his registration has expired, or has been revoked or suspended by the commissioner, or who shall otherwise neglect or refuse to comply with any of the provisions of this article, shall be guilty of a felony, and upon conviction thereof, shall be punished by a fine of not more than five thousand dollars, or by imprisonment in the penitentiary for not more than five years, or by both such fine and imprisonment, in the discretion of the court.

Section 10. Applicability of Sections.—Sections three, four, six, nine, and twenty-seven, article one of this chapter, shall not apply to this article. All other sections of this chapter shall apply fully to this article.

Section 11. Provisions Severable.—If any part or section of this act shall be declared unconstitutional or invalid by any court, such declaration shall not affect any other part or section hereof.

Section 12. Article Nine, Chapter Thirty-three, Repealed.—Article nine, chapter thirty-three of the code of West Virginia, one thousand nine hundred thirty-one, is hereby expressly repealed.

## CHARTER POWERS OF FIDELITY ASSURANCE ASSOCIATION UNDER 1912 AMENDMENT

III. The objects and purposes for which this Corporation is formed are as follows:

To purchase, acquire, buy, sell, own, hold, dispose of and deal in stock, bonds, mortgages, debentures, obligations, and other securities of corporations and persons for its own account and for others on commission; to loan money on real estate security; to loan money on personal and other security; to acquire, own, deal in and sell real estate, to erect houses thereon, rent and sell the same, to lay out real estate into divisions and lots and to sell and dispose of same; to deal in real estate and to buy, sell and exchange the same for others for a commission or reward; to underwrite in whole or in part any issue of stocks, bonds or other securities; to transact as agents on commission the general business of real estate and insurance in all its branches; to transact on commission the general business of a fiscal agent; to transact any other business incident to any of the above named enterprises which a person, firm or partnership might engage in or do.

To carry on, by purchasing existing businesses, or otherwise, the business of soliciting or receiving deposits or payments on any annuity contracts, certificates or annuity bonds; in fixed and stipulated instalments or otherwise; to acquire and sell and offer for sale or delivery any contract, certificate or bond, of any person, association or corporation, now or hereafter engaged in this state in the business of soliciting, or receiving deposits or payments of any kind of annuity contracts, certificates or annuity bonds; and further to engage in the business of placing or selling certificates, bonds, debentures, certificates of interest, or investment securities of any kind on the partial payment, instalment, or any other

plan of payment, and providing for the sale, redemption, or retiring of the same or any part thereof; and generally to carry on all lawful business necessary or incidental to all or any of the above mentioned objects.

The designation of any one of the objects and purposes aforesaid is not intended and shall not be taken to be a limitation or qualification upon any other of the said designated objects and purposes.

FILE COPY

IN THE

# Supreme Court of the United States

OCTOBER TERM, 1942

## No. 319

FIDELITY ASSURANCE ASSOCIATION, a corporation, Debtor, and CENTRAL TRUST COMPANY, Trustee for Fidelity Assurance Association,

*Petitioners,*

vs.

EDGAR B. SIMS, Auditor of the State of West Virginia, and Ex Officio Insurance Commissioner of the State of West Virginia; ROSS B. THOMAS and H. ISAIAH SMITH, West Virginia State Court Receivers; BANKING COMMISSION OF WISCONSIN; CHAS. R. FISCHER, Commissioner of Insurance and Permanent Receiver for debtor corporation in and for the State of Iowa; JOHN B. GONTRUM, Insurance Commissioner of the State of Maryland; DEWEY S. GODFREY, Missouri State Court Receiver; L. H. BROOKS, Trustee, FREDERIC LEAKE and A. L. GOLDBERG, JR., Trustee; and SECURITIES AND EXCHANGE COMMISSION,

*Respondents.*

**On Writ of Certiorari to the United States Circuit Court of Appeals for the Fourth Circuit**

## REPLY BRIEF OF PETITIONERS

JAMES R. FLEMING,
JOHN V. RAY,
HOMER A. HOLT,
*Counsel for Fidelity Assurance Association, Debtor.*

T. C. TOWNSEND,
HILLIS TOWNSEND,
*Counsel for Central Trust Company, Trustee for Fidelity Assurance Association.*

JARRETT PRINTING COMPANY, CHARLESTON, W. VA.

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IN THE

# Supreme Court of the United States

OCTOBER TERM, 1942

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## No. 319

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FIDELITY ASSURANCE ASSOCIATION, a Corporation, Debtor, and CENTRAL TRUST COMPANY, Trustee for Fidelity Assurance Association,

*Petitioners,*

VS.

EDGAR B. SIMS, Auditor of the State of West Virginia, and Ex Officio Insurance Commissioner of the State of West Virginia; ROSS B. THOMAS and H. ISAIAH SMITH, West Virginia State Court Receivers; BANKING COMMISSION OF WISCONSIN; CHAS. R. FISCHER, Commissioner of Insurance and Permanent Receiver for Debtor Corporation in and for the State of Iowa; JOHN B. GONTRUM, Insurance Commissioner of the State of Maryland; DEWEY S. GODFREY, Missouri State Court Receiver; L. H. BROOKS, Trustee, FREDERIC LEAKE and A. L. GOLDBERG, JR., Trustee; and SECURITIES AND EXCHANGE COMMISSION,

*Respondents.*

---

**On Writ of Certiorari to the United States Circuit Court of Appeals for the Fourth Circuit**

---

## REPLY BRIEF OF PETITIONERS

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### FOREWORD

Three briefs have been filed on behalf of various respondents. One has been filed on behalf of the Banking

Commission of Wisconsin and the Commissioner of Insurance of Iowa, jointly, to which we shall refer as the "Wisconsin Brief". Another has been filed on behalf of Edgar B. Sims, State Auditor of West Virginia, and H. Isaiah Smith and Ross B. Thomas, West Virginia State Court Receivers, to which we shall refer as the "West Virginia Brief". A third has been filed on behalf of the Insurance Commissioner of Maryland, to which we shall refer as the "Maryland Brief". It had been expected that a Brief would be filed on behalf of L. H. Brooks, Trustee, et al., Tennessee creditors, but, although the time for filing respondents' briefs has long since passed, no such brief has yet been received. If such brief were filed, it would be referred to as the "Tennessee Brief". A brief purporting to be a "Joint Amici Curiae Brief" on behalf of the attorneys general of a number of states and some other counsel has been filed.

The appropriate state abbreviations, followed by numerals, will indicate page references to these state briefs. Otherwise, the terminology and references will be in general the same as those followed in the Brief of Petitioners.

## SCOPE OF REPLY BRIEF

The number and volume of the several briefs of the respondents make impracticable, if not impossible, the preparation and printing of separate detailed reply briefs, or of a single brief replying in detail to the several briefs of the respondents within the time elapsing between the filing of the respondents' briefs and the day of argument. We shall present in this reply brief some of the fallacies common to the respondents' briefs and generally reply thereto, and, in addition, shall comment upon some of the more flagrant errors of the several briefs of the respondents.

## ARGUMENT

The respondents take the position that nothing will constitute a reorganization of Fidelity except the complete rehabilitation of Fidelity as a going concern carrying on the same business that Fidelity carried on prior to December 31, 1940, in substantially the same manner; and, since it is obvious that there must be some readjustment of Fidelity's business, they argue that there is no alternative between such complete rehabilitation and immediate liquidation. Upon this fallacious premise the respondents then argue that, since nothing is to be done except immediately to liquidate and distribute the assets of Fidelity, the petition was not filed in good faith for the reason that under Sec. 146 (4) the state courts better subserve the interests of creditors than does the reorganization court under Chapter X.

We shall first demonstrate the fallacy of this false premise and then show that, even if the premise were sound, the conclusion would, nevertheless, be erroneous.

### The Respondents' Contention that Reorganization Can Be Nothing Except Complete Rehabilitation of Fidelity as a Going Concern.

The respondents insist that there can be no reorganization of Fidelity other than complete rehabilitation (Wis., 98-99; W. Va., 46, 82; Md., 54). The respondents make this contention without reference to either statutory support from or judicial application of Chapter X. They (except in the Maryland brief and in that only as to the statute) make this contention without any effort to explain away the express provisions of Sec. 216 (10), or to differentiate or show the inapplicability of the many decisions of courts of competent jurisdiction holding otherwise. To reply to this contention of the respondents, other than to refer to Sec. 216 (10) and to the cases hold-

ing otherwise cited in the footnote to page 42 of Petitioners' Brief, would be mere repetition and would unduly extend this reply brief.

**Petitioners Deny that They Have Conceded Impossibility of Rehabilitation**

The petitioners emphatically deny that rehabilitation as a going concern is an impossibility or that they have at any time made any such concession. Unquestionably, complete rehabilitation is not a strong probability, principally for the reason that there are other likely methods of reorganization which would seem to be more available and which make it unnecessary that the petitioners rely upon complete rehabilitation.

Changes in interest rates and the extension of maturity dates with respect to the Fidelity contracts obviously would permit Fidelity to be rehabilitated.

As a matter of fact, Mr. Koontz, whose firm is now the attorneys for the West Virginia Receivers and speaks for the West Virginia State Auditor (836), and who for several years was a director of Fidelity and acted as an attorney for Fidelity, particularly in relation to financial matters, testified in the hearing of this case that during 1938, 1939, and 1940 he was of the opinion that Fidelity was a company which should be rehabilitated and which "*could be* rehabilitated." (1202-1204.)

Fred Risley, president of Fidelity, testified that Fidelity could operate under the Insurance Company Act of 1940 loading provision, and that the reserve requirement made it impossible for Fidelity to qualify. (866-867.)

**The Contention of the Respondents that the Petitioners Rely Only on Slow Liquidation as a Plan of Reorganization.**

The respondents argue from another false premise: that the petitioners rely solely upon a slow, orderly, and

unified liquidation as a means of reorganization and insist that such liquidation is not within the scope of reorganization.

In both of these contentions the respondents err. The petitioners do not rely solely upon any such liquidation. From the record it would seem that among the most likely methods of reorganization would be the organization of a new mutual company, the sale of Fidelity's assets to a stronger company under a contract which would provide for the continuance of Fidelity's business for the benefit of the creditors, the annuity contracts to be so modified as to interest rates and maturities as the circumstances might require, or the merger of the Fidelity business with the business of some other corporation, insurance or annuity, in either case the Fidelity contracts to be continued as annuity contracts or replaced by insurance contracts where the contract holder is physically insurable, coupled also with the right of the creditor to receive within a reasonable time the payment of the value of his claim in cash in the event he should not desire to accept either an annuity or an insurance contract. Any such reorganization would eliminate in large measure the heavy overhead of Fidelity which has proven to be so disastrous.

However, from the standpoint of passing judgment upon good faith in filing the petition, a well-ordered, unified liquidation is within the scope of reorganization (See cases, Petitioners' Brief, 50; S. E. C. Brief, 47 and 48), and the District Court was well within its proper powers in considering such possibilities when that Court concluded that the petition was filed in good faith even though the court may properly have felt that there would not likely be an occasion to resort to this particular plan of reorganization. The petitioners and the S. E. C. may

with perfect right rely upon this plan of reorganization, along with other more desirable plans, but, most certainly this possibility is not relied upon as the only available plan of reorganization.

When the respondents argue that a well-ordered, unified liquidation does not constitute reorganization and that liquidation, as distinguished from reorganization, is inevitable in this case (Wis., 113; Md., 58; W. Va., 82; 89), they again ignore the clear decisions of courts of competent jurisdiction because they know that they cannot escape the applicability of such decisions if they should undertake to discuss them.

**Respondents' Contention that from the Factual Standpoint Liquidation Is Inevitable.**

The respondents uniformly argue from an unestablished premise that, factually, speedy liquidation and distribution of the assets of Fidelity is inevitable. The Maryland Brief (Md., 46; 50) would belittle the testimony of qualified witnesses that Fidelity could and should be reorganized. This Honorable Court is again invited to look to the full testimony of said witnesses as it is referred to in Petitioners' Brief at pages 44-45, and then contrast that testimony with that of the witness Steussey (1005-1052), who was the only witness who testified that in his opinion Fidelity could not be reorganized. Steussey's opinion appears to have been based largely upon the fact that the Fidelity sales organization had been disbanded (1027-1028). Steussey was himself a former Fidelity salesman (1006) as well as a very versatile witness.

Not infrequently actions speak louder than words and so it is in this case. The state proceedings were originated by the West Virginia Auditor who with probable accuracy may be referred to as the principal respondent herein. Counsel for the West Virginia Receivers says

for reorganization

that he also speaks for the West Virginia Auditor (836), and, in the hearing of this cause, stated in open court:

> "Mr. Palmer: I had that intention with this witness to develop that. Might I also state that I think, as stated before on the record, that it is the opinion of myself as counsel that while a life insurance plan is feasible in the State Court, it is not feasible in the Federal Court because of my own personal view of the law that this Court cannot reorganize Fidelity into or keep it as an insurance company for the reason that I think this Court has no jurisdiction to give birth or to help grow an insurance company where it cannot bring it its demise or obsequies." (1076-1077).

The earlier statement, likewise made in open court in answer to a question by the Court, was:

> "The Court: Mr. Palmer, there is one thing the Court would like to get straightened out in its own mind as to the position you are taking in this suit here. As I understand, you represented the receivers in the state court proceeding, and Mr. Smith as one of the receivers says that his whole thought in the matter was to try to effect a reorganization, and I presume that you as his attorney in that matter were one with him in that thought. Now, you are appearing here and from your questions it seems that you are endeavoring to prove that there is no possibility of any reorganization. That appears inconsistent to the Court and I would like to know what the explanation of that is, Mr. Palmer.
>
> "Mr. Palmer: I think that is a fair question and I will be more than glad to state my position on the record, your Honor. If the Court please, I understand this: that under this table just introduced in evidence as Exhibit No. 28 there are 15 different states which required deposits and 20

states where the debtor was required to obtain a license, (fol. 637) and there were some seven to nine different contract funds and series in these various states, so taking each one for one it adds up to a total of 117 classes of creditors. Now, it is my opinion that it is impossible at this time to obtain the consent of two-thirds of each of these classes of creditors to any plan of reorganization that can be presented. In the second place, it is my opinion that no plan can be formulated which this Court will approve which will have the approval of that number of creditors. However, I do feel that there are a large number of contractholders who would prefer, as Mr. Smith and others have said, some form of company whereby periodic installment savings can be made; that they like the idea and are willing to continue it, and it is my personal belief, as counsel, and having talked to some others about it, that if a group as large as, say, $10,000,000 or 40% would approve of such a plan, or 50% that in state court proceedings they voluntarily agree to that, that then an insurance company could be formed by their voluntary agreement which could do that; that, however, the Federal Court's hands are bound by Chapter 10 proceedings and unless two-thirds agree, even though 40% or 50% or 60% would agree, the Court would have to reject the plan; and I (fols. 638-660) sincerely feel and I think that the state court receivers feel that in state court, particularly prior to the bringing of this suit, there was every possibility and likelihood of a very substantial part, a large enough part to make it worthwhile, of these contractholders agreeing to some plan among themselves for voluntarily keeping this going and not having at the very last a forced liquidation.

"The Court: Did you then, and do you now, consider that such a reorganization on the part of

any percentage of the contractholders is beneficial to them?

"Mr. Palmer: Yes, sir, I do.

"The Court: Then your only doubt, and your only question, is as to the possibility of getting a sufficient percentage to agree?

"Mr. Palmer: Yes, that is correct, your Honor." (486-487).

It will be recalled that the West Virginia proceeding was instituted for reorganization and the letter of the Judge of the Circuit Court of Kanawha County presented in the Appendix to the West Virginia Brief (W. Va., 128-130) shows beyond doubt that the Circuit Court of Kanawha County regarded the proceeding instituted by the West Virginia Auditor as one for reorganization.

In the Maryland Brief (Md., 62) it is stated that the Judge of the Circuit Court of Kanawha County was advised that such proceeding was for reorganization.

The president of Fidelity, who participated in the various conferences with the West Virginia Auditor, the Securities and Exchange Commission, and Fidelity's attorneys, states that the sole purpose of the West Virginia State proceeding was to hold the assets in statu quo while the company could arrive at some reorganization plan.

Though this particular testimony was referred to by record reference in Petitioners' Brief, we believe its significance in this connection warrants its reproduction here:

"Mr. Palmer: Isn't this true, Mr. Risley, that the company recognized that something must be done, and that they were not objecting to some sort of proceedings brought in order that the assets

might be held in statu quo while the company could arrive at some reorganization plan?

"A. That was the sole purpose.

"Q. And that that is why there was no objection on the company's part to Mr. Sims suit? Isn't that correct?

"A. That is correct, yes, sir.

"Q. The company knew that there had to be something done, otherwise there might be a run on the company by cash surrenders which would give those who got there first their money and those who came last would not get (fol. 2606) any?

"A. That is correct.

"Q. So that the company had, through its officials, after this letter of Mr. Sims as well as before, discussed with Mr. Sims the possibility or need of such a suit, and also had discussed the possibility or need of a federal court suit? Isn't that right?

"A. That is right.

"Q. And it was only after a thorough discussion and weighing of all matters that the company decided that it preferred, if it had a choice, the state court proceeding?

"A. After weighing the matter it was the unanimous opinion of the board of directors that the state court method would be the best.

"Q. And isn't it further true that not only the sentiment, or the expressed sentiment, of the board of directors was that that state court proceeding would lead to a reorganization of the company rather than a liquidation of it?

"A. Reorganization was the only thing that we were considering.

"(fol. 2607) Q. There was no thought of any kind, either by Mr. Sims, by the SEC or by the company, of a liquidation, but only a thought of some sort of reorganization? Isn't that true?

"A. Reorganization is the only word that I heard mentioned in any of those conferences." (895-896)

When, we may ask, did the West Virginia State Auditor and counsel for the West Virginia Receivers conclude that liquidation was inevitable? The letter of March 21, 1941, from the West Virginia Auditor to Mr. Koontz, Attorney for Fidelity (W. Va., 126-127), indicates that, had Fidelity determined to file a petition under Chapter X prior to the institution of the West Virginia State Court Proceeding by the Auditor, the West Virginia Auditor would have been satisfied.

We think there is little doubt but that, had Fidelity presented a petition under Chapter X prior to the institution of the West Virginia State Proceeding, not only would it have not been asserted by anyone that it was unreasonable to expect that a plan of reorganization could be effected, but that the superiority of the bankruptcy court over the several state courts for these purposes would never have been questioned, and it would have never been suggested that Fidelity was an insurance company, as the State Auditor in his answer in this proceeding originally admitted that Fidelity was not an insurance corporation and was a corporation eligible for bankruptcy (59).

It may be that these various admissions by the West Virginia Auditor and counsel for the State Receivers are not binding upon the other respondents. On the other hand, the record shows that all of the state proceedings

were, in reality, instigated by the West Virginia Auditor thinking that the other states would join in a program of holding the assets of Fidelity in statu quo pending a voluntary reorganization in the State Courts. The Wisconsin officials disagreed with the West Virginia State Court Receivers and proceeded to commence liquidation. It was then apparent to the directors of Fidelity that if there were to be any reorganization it would have to be under Chapter X, and the directors, with commendable foresight, proceeded to cause the petition to be filed.

The respondents would make much of the fact that Fidelity had not been financially strong for many years and that Mr. Koontz and Mr. Messick, on Fidelity's behalf, had made efforts to bring in new capital but had not been successful. It must be remembered that at no time prior to the filing of the petition under Chapter X had Fidelity sought any reorganization or recapitalization other than such as would preserve a corporate interest of value to the stockholders. In other words, Fidelity had not theretofore put its affairs in a position where the interests of creditors alone were to be considered. The Latta projected plans contemplated a voluntary reduction in the value of their contracts by the contract holders of about fifteen per cent (Exhibits 111, 112, pp. 1069 ff.; 1093; 1100; 1126), and Fidelity expected to rely upon salesmanship to put such a program over (1094). Under the standards of Chapter X such a reorganization would not have been fair or reasonable. That is probably the reason why Fidelity desired to go into the State Court rather than into the Bankruptcy Court (*Case* v. *Los Angeles Lumber Co.*, 308 U. S. 106), but, when Fidelity's petition was filed in the reorganization court under Chapter X, Fidelity irretractably gave up any hope of preserving any value to the stockholders in the event it should prove, as would seem to be the case, that the assets of Fidelity were less than its debts (*Case* v. *Los Angeles Lumber Co., supra*).

The failure of Fidelity to enlist new capital under those circumstances is not surprising and does not refute the probability of reorganization upon a plan in which the interests of creditors only is to be considered. The earlier efforts made by Fidelity were not under reorganization statutes but were planned upon a basis purely voluntary.

The very nature of the Fidelity assets bespeaks probabilities of successful reorganization because of the facility by which new certificates or contracts might be issued according to the exact interests of the various creditors.

Good faith in the filing of the petition under Chapter X is a question of fact upon which the findings of the trial court should not be disturbed unless clearly erroneous (*Wayne United Gas Co.* v. *Owens Illinois*, 91 F. (2d) 827, 831; *Seaboard Terminals* v. *Western Maryland*, C. C. A. 4, 108 F. (2d) 911.)

**The Respondents' Contentions that the Assets Deposited by Fidelity with the Various States Are Not Property of Fidelity, that the Chaper X Proceeding and the Injunction Issuing Therefrom Constitute a Suit Against the States Contrary to the Eleventh Amendment to the Federal Constitution, and Constitute an Interference with the Police Powers of the States Contrary to the Tenth Amendment to the Federal Constitution.**

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The respondents argue that inasmuch as Fidelity is insolvent, its assets heretofore deposited with the several states are no longer property of Fidelity, and for that reason cannot be reached in this proceeding, that even if such deposits are property of Fidelity this proceeding constitutes a suit against the sovereign states contrary to the Eleventh Amendment, and that to interfere in this proceeding in any way with such state deposits would

involve federal action contrary to the Tenth Amendment to the Federal Constitution as an interference with the exercise of the police powers reserved to the states.

These arguments are presented by the respondents upon two theories. One theory is, that, since these deposits cannot be reached by the Chapter X proceeding, the reorganization court cannot control sufficient assets of Fidelity to make reorganization possible. The other theory is, that, since the bankruptcy court cannot deal in any way with such deposited assets, either by preserving their status by injunction or obtaining their possession by turn-over order, the petition has not been filed in good faith, for the reason that the prior court proceedings, in which the jurisdiction of the state courts is not questioned by the respondents, will better subserve the interests of creditors.

**Deposits Are Property of Fidelity**

Whatever may be the verbiage of the various state statutes requiring the deposits, the deposits are made for the benefit of the contract holders, the Fidelity creditors, and the states have no financial interest whatsoever in the deposits. Even the Maryland brief, which is based entirely upon the argument that the Chapter X proceedings cannot reach the state deposits, concedes that the states have no pecuniary interest in such deposits. (Md. 15.)

If for purposes of reorganization, pledged or mortgaged assets were regarded as assets of the debtor only when the value of the assets exceeded the amount of the debts, there would be very little subject-matter upon which Chapter X might operate.

The respondents apparently are unable to cite any authorities which sustain their argument in this respect.

In the Maryland brief, the cases *In re Prudence Co., Inc.*, 82 F. (2d) 755; *Warder* v. *Brady*, 115 F. (2d) 89; and

*Seaboard Terminals* v. *Western Maryland Railway*, 108 F. (2d) 911, are cited in support of the contention that the property is not that of the debtor unless an equity remain. None of these cases sustain such position. In the *Prudence* case, the property involved had previously been transferred by the Prudence Company to another company. In *Warder* vs. *Brady*, certain payments into a sinking fund had become the property of the beneficiaries of the sinking fund. Pledged or deposited property was not involved. In the *Seaboard Terminals* case, title, not only legal title but beneficial ownership in the property in question, had been conveyed to the Maryland Terminals Corporation. Seaboard Terminals had only a lease thereon which had been forfeited, and the Seaboard Terminals failed in its effort to establish that the conveyance to the Maryland Terminals Corporation was a mere mortgage in the form of a conveyance, rather than an outright conveyance.

On the other hand, there are many cases in which securities of less value than the debt secured are dealt with by the reorganization courts, and the case *In re Central Funding Corporation*, 75 F. (2d) 256, expressly holds that insolvency does not destroy the petitioner's interests in assets for purposes of reorganization. In that case it is observed:

> "It makes no difference whether the debtor has an equity of any value or not. * * * To restrict the Act to reorganizations where the debtor has an equity would be to deprive the section of much, if not most, of its usefulness."

**Injunction Order Is Not Suit Against State**

A suit is not a suit against a state contrary to the Eleventh Amendment to the Federal Constitution, unless some relief is sought against the state as such, or the control of political action is sought whether the de-

fendant in name be a state or a state officer. *Regan* v. *Farmers Loan & Trust Company*, 154 U. S. 362,

The respondents concede that the states do not have any pecuniary interest in these state deposits. So far as we have been able to find, the decisions of the courts uniformly hold that such deposits are subject to court orders.

In the case of *Hobbs, Commissioner of Insurance of Kansas*, vs. *Occidental Life Insurance Co.*, 87 F. (2d) 380, the insurance commissioner was required to deliver the deposited securities to the Occidental Life Insurance Company, which had reinsured the liabilities of the Federal Reserve Life Insurance Company, which had made the deposit, although Hobbs insisted that such suit was against the state. See also *Kansas* vs. *Occidental Life Insurance Company*, 95 F. (2d) 935 (certiorari denied, 305 U. S. 603).

In the case *In re Bajardi*, 8 F. (2d) 551, relied upon in the West Virginia brief (W. Va. 49) it was held that the Federal Court was competent to require the New York superintendent of banking to turn over to the trustee in bankruptcy securities deposited with the superintendent of banking pursuant to statute.

In *Morrill* v. *American Reserve Bond Co.*, 151 F. 305, the treasurer of Missouri was required to turn over to a receiver appointed by the Federal Court securities deposited with him pursuant to a Missouri statute.

In *U. S.* vs. *Knott*, 298 U. S. 544, it was held that the deposit of securities by a surety company with the treasurer of Florida, pursuant to a Florida statute, for the benefit of Florida creditors did not divest the surety company of its title. See also *Porter* vs. *Beha*, 12 F. (2d) 513; *Hayne* vs. *Metropolitan Trust Company*, 67 Minn. 245, 69 N. W. 916; *Prewitt, Insurance Commissioner* vs. *Illinois Life Insurance Co.*, 123 Ky. 36, 93 S. W. 633.

The respondents rely principally upon the cases of *Lankford* vs. *Platte Iron Works Co.*, 235 U. S. 461, and *Farish* v. *State Banking Board*, 235 U. S. 498. These cases have no application whatever to the case at bar. The funds there involved were funds collected by the state for the purpose of carrying on the governmental function of insuring bank deposits. The funds there involved were, in fact, asse s of a governmental agency, not unlike state workmen's compensation or state unemployment compensation funds, and the state court in discussing this fund had said that it was "as much a fund of the state as the common school fund."

That the other cases relied upon in the Maryland brief on this point involved governmental funds or governmental property is too clear from a consideration of those cases to merit detailed distinguishment herein.

In the West Virginia brief, the case of *Rollo, Assignee*, v. *Andes Insurance Company*, 23 Gratt. (Va.) 509, is relied upon. That case involved an attempt to garnishee funds in the hands of the state treasurer. In Virginia and West Virginia a garnishment procedure seeks, and if prosecuted successfully, results in, a judgment against the garnishee. This was, of course, the equivalent of a suit against the Commonwealth of Virginia. In the West Virginia brief, *State ex rel Stevenson* v. *Stephens*, 136 Mo. 537, 37 S. W. 506, appears also to be relied upon. As a matter of fact, the funds there involved, deposited with the state trasurer, were held not to be state funds, and the treasurer of the State of Missouri was required by mandamus to pay the money out to the holder of a mortgage lien note on real estate which secured a $100,000 note deposited by an investment company with the state treasurer pursuant to state law requiring such deposits for the benefit of investors as a condition to the right of such company to do business in the state, without the necessity

of complying with the state laws relating to the disbursement of state moneys.

The case of *Blake* v. *McClung*, 172 U. S. 239, also relied upon by the West Virginia brief, simply involved the constitutionality of a Tennessee statute which provided that the assets of a corporation admitted to do business in the State of Tennessee should be held for the payment of resident Tennessee creditors in preference to crditors residing in other states. This statute was held unconstitutional, insofar as natural persons were concerned, because it violated the privileges and immunities clause of the constitution. It was collaterally observed in the opinion that states may require insurance companies to make deposits on the security of claims of resident creditors.

We are certain that the Court is sufficiently familiar with the case of *Ex parte Ayers*, 123 U. S. 443, and its inapplicability to the case at bar to make any comment thereon here unnecessary.

The case of *Mitchell* vs. *Lay*, 48 F. (2d) 79, is also relied upon in the West Virginia brief. In reading this case petitioners' counsel had appreciable difficulty in identifying it with the case discussed thereunder in the West Virginia brief. In the West Virginia brief (W.Va., 68) it is said that a Federal Court proceeding was instituted in California ancillary to a Texas proceeding, and that in the California District Court the insurance commissioner of California was enjoined from interfering with "the Federal Court Trustee's possession of the Debtor's deposited assets." There was no Federal Court Trustee, and the case did not involve any bankruptcy proceeding. The California Federal Court proceeding was a diversity of citizenship proceeding actually instituted prior to the institution of the suit in Texas, to which it is said in the West Virginia brief

that the action was ancillary. The plaintiff was a mere claimant against the insurance company, and had a special fund to which she had the right to look for reimbursement, but sought to have administered in the Federal Court in California all of the assets of the insurance company. The real reason for the dismissal was that the plaintiff had no standing to bring the suit in the first instance.

**Argument Under the Tenth Amendment**

We believe that the cases hereinbefore discussed, such as *Hobbs* v. *Occidental Life Insurance Company* and, *In re Bajardi*, in which moneys deposited with state officials have by the orders of Federal Courts been required to be turned over to the persons entitled thereto, sufficiently answer the contention that such deposits with state officials cannot be reached, even by the processes of courts of bankruptcy, without invading the reserved police powers of the states contrary to the provisions of the Tenth Amendment to the Federal Constitution.

Much of the argument in the Maryland brief on this point relates to the so-called turn-over order entered by the District Court. The District Court amended *nunc pro tunc* the turn-over order and eliminated therefrom the turn-over requirements, but provided by injunction for the freezing or holding in statu quo of the state deposits.

In the Maryland brief, it is very frankly admitted that if the Maryland argument is sound, then the provisions of 67(f) of the Bankruptcy Act, as added by Section 29(b) of the Investment Company Act of 1940, would be unconstitutional.

Such impotency of the courts of bankruptcy, exercising a Federal power expressly conferred by the Federal Constitution, would indeed be a vast departure from all concepts heretofore entertained and judicially recognized with respect to the supremacy of the constitutional

powers of the national government generally, and particularly as to bankruptcy. (See *International Shoe Company* vs. *Pinkus*, 278 U. S. 261; *Continental Illinois National Bank* v. *Chicago R. I. & P. R. Co.*, 294 U. S. 648; *In re Park Beach Hotel Corp.*, 96 F. (2d) 886 (Cert. Den., 305 U. S. 638); *In re Merced Irrig. Dist.*, 25 F. Supp. 981, 114 F. (2d) 654 (Cert. Den., 311 U. S. 718).)

As we have observed above, we need not consider whether the turn-over order was pre-maturely entered or not. The cases above referred to clearly sustain the power of the reorganization court to issue such turn-over orders when appropriate to the exercise of the court's powers in bankruptcy, but at this time we are concerned only with the injunction order freezing the state deposits. In the Maryland brief, it is conceded that under the case of *Continental Illinois National Bank* vs. *Chicago R. I. & R. R. Co.*, 294 U. S. 648, it is appropriate that the bankruptcy court preserve the debtor's assets by injunction in order to afford an opportunity for reorganization. In the Maryland brief, it is also conceded that the *Central Funding Corp.* case (75 F. (2d) 256), sustains a turn-over order entered against a state official when a plan of reorganization has resulted in the accomplishment of the purposes for which the deposit was provided.

In the case at bar, when reorganization is effected, certainly it will not be contended by the respondents that the reorganization court might not properly enter an order directing the proper disposition of such state deposits.

So far as the present status of this case is concerned, the case of *Fischer* vs. *American Life Insurance Company*, 314 U. S. 549, relied upon in the West Virginia brief, clearly holds that rights in the *res* of the suit may be adjudicated and determined even though the possession of the *res* is in another court and is not disturbed. Thus the Maryland brief concedes the power of the District Court

to preserve the assets to afford an opportunity for reorganization and to direct the disposition of the assets upon reorganization; even though, for purposes of argument, it might be conceded that the possession of such deposits could not be disturbed prior to reorganization. Such a concession for purposes of argument would, however, be contrary to the established law.

Unquestionably, the District Court in exercising its jurisdiction under Chapter X has jurisdiction over all of the assets of Fidelity, and over all the creditors of Fidelity. When the District Court shall have adjudicated the rights of the creditors, certainly the purposes of the state deposits will have been accomplished, and no state would presume to retain such deposits after the purposes thereof had been accomplished. In the reorganization court, the dissenting creditors will be bound provided two-thirds of the creditors approve the plan of reorganization.

**Statutory Receivership Cases Not Applicable**

The respondents rely upon the case of *Pennsylvania* vs. *Williams*, 294 U. S. 176, and some other cases of the same general import, including the case of *Picklesimer* vs. *Morris*, 101 W. Va. 127, 132 S. E. 372. In *Pennsylvania* vs. *Williams* it was held that the District Court should relinquish jurisdiction of a suit based upon diversity of citizenship in favor of a statutory state receivership. In *Picklesimer* vs. *Morris*, the Supreme Court of Appeals of West Virginia held that the West Virginia courts would not supersede a statutory receivership for the administration of an insolvent bank. Both decisions, of course, were predicated upon the sufficiency and the adequacy of the statutory receiverships. The principle of judicial relinquishment in favor of statutory receivership proceedings is not involved in this case. We have no

statutory receivership in this case. In the West Virginia brief (W. Va., 95), it is said:

> "(12) It is true that the several States not only threaten but intend to distribute the assets held in those States, but it is not true that this is to be done without judicial proceedings. On the contrary, liquidation and distribution by the States will be made only in the State Courts thereof. * * *"

In the other briefs, it appears that the jurisdiction of the courts has been invoked with respect to all of the state deposits represented by any of the respondents.

The Auditor of the State of West Virginia, by way of illustration, has absolutely no powers of statutory receivership or liquidation. The auditor has no authority to disburse one cent of the deposits, or to accept a single proof of claim. All that the Auditor of West Virginia can do is to cause a suit in equity to be instituted in the Circuit Court of Kanawha County, West Virginia, pursuant to the provisions of Section 45 of Article 2 of Chapter 33 of the Code of West Virginia (Petitioners' Brief, Appendix 69). There is nothing to indicate that the state auditor has the exclusive right to invoke the jurisdiction of the courts for the purpose of administering such deposits. Such simple provisions are not ordinarily held to be exclusive of the right of other interested parties to institute and maintain such suits. (See *State ex rel. Hutchinson* (S. C.), 189 S. E. 475.)

If the principle of judicial relinquishment to statutory receiverships were involved, then clearly such statutory receiverships would not be "a prior proceeding * * * pending in any court" within the meaning of Section 146(4) of Chapter X.

It is obvious that the case of *Picklesimer* vs. *Morris*, supra, has no application here. The West Virginia stat-

utes provide for statutory receivership and liquidation of insolvent banks. (West Virginia Code, Chapter 31, Article 8, Section 32.) There is no such statutory provision with respect to corporations under the jurisdiction of the West Virginia State Auditor.

**Respondents' Contention that Only State Courts Can Determine Questions of Law Involved.**

In each of the respondents' briefs (Md., 68; Wis., 147; W. Va., 70) the respondents argue that the determination of the rights and interests of the creditors of Fidelity will necessitate the determination of many questions of state law, particularly the construction of the statutes requiring the deposits.

We would not suggest that as this cause proceeds some questions of state law, even some questions of state statutory law, may not have to be decided. Quite obviously one of the first questions to be decided will be the measure of the individual contract holder's participation in whatever assets he may be entitled to share, that is to say, whether upon the cash surrender value, the reserve value or the total amount of money paid in, including the rights of those who are in default to take advantage of the redating provisions. This is a question of the construction of the various contracts rather than of the construction of state statutes. Since the contracts were issued from Wheeling, West Virginia, upon applications from the purchasers therefor solicited elsewhere, and it was provided that payment should be made at the Home Office at Wheeling, West Virginia, it would seem that the law of West Virginia would be applicable (*John Hancock Mut. Life Ins. Co.* v. *Yates*, 299 U. S. 178), if in a Chapter X proceeding it should become material to apply the special law of any state.

Whether or not the deposits in the several states were of assets free of any prior obligations, trust or otherwise,

or whether any part of any state deposit is of assets which the particular state might not lawfully hold for the benefit of the creditors resident in the particular state (*Porter* v. *Beka*, 12 F. (2d) 513), is not a question of statutory construction. When these questions are determined, it is likely that the participation of the various creditors entitled thereto in a particular state deposit will be relatively a simple matter and one not likely requiring any technical interpretation of the state depository laws.

Be that as it may, we do not understand that the rule of *Erie R. Co.* v. *Tompkins*, 304 U. S. 64, provides any iron clad rule of law applicable in bankruptcy proceedings.

In the case of *Prudence Realization Corp.* v. *Geist*, 1941, 316 U. S. 89, 95 it is observed:

> "Nothing decided in *Erie R. Co.* v. *Tompkins*, 304 U. S. 64, supra, requires a court of bankruptcy to apply such a local rule governing the liquidation of insolvent estates. The bankruptcy act prescribes its own criteria for distribution to creditors. In the interpretation and application of federal statutes, federal not local law applies. (Cases cited.) The court of bankruptcy is a court of equity to which the judicial administration of the bankrupt's estate is committed, *Securities & Exchange Commission* v. *U. S. Realty & Improvement*, 310 U. S. 434, 455-457, and it is for that court—not without appropriate regard for rights acquired under rules of state law—to define and apply federal law in determining the extent to which the inequitable conduct of a claimant in acquiring or asserting his claim in bankruptcy requires its subordination to other claims which, in other respects, are of the same class."

In the case of *D'Oench, Duhme & Co.* v. *Federal Deposit Ins. Corp.*, 1941, 315 U. S. 447, in considering the question whether the Federal Deposit Insurance Corporation authorized to sue or be sued in any court of law or equity, state or federal, could recover on a renewal note acquired by it as a part of the collateral securing a loan to a bank insured by it, the receipts for the originals of which contained a provision that they would not be called for payment, of which provision the Federal Deposit Insurance Corporation had no notice, it was concluded that a federal question was presented and that a federal court was not bound to follow state law in deciding such question. In the opinion of the court referring to the principle of *Erie R. Co.* v. *Tompkins, supra*, it was observed:

> "We held in the latter decision (*Klaxon Co.* v. *Stentor Electric Co.*, 313 U. S. 487) that a failure of a federal court in a diversity of citizenship case to follow the forum's conflict of laws rules 'would do violence to the principles of uniformity within a state' upon which *Erie R. Co.* v. *Tompkins*, 304 U. S. 64 was based. The jurisdiction of the District Court in this case, however, is not based on diversity of citizenship. Respondent, a federal corporation, brings this suit under an Act of Congress authorizing it to sue or be sued 'in any court of law or equity, state or federal.' • • • Whether the rule of the Klaxon Co. Case applies where federal jurisdiction is not based on diversity of citizenship, we need not decide. For we are of the view that the liability of petitioner on the note involves decision of a federal not a state question under the rule of Deitrick v. Greaney, 309 U. S. 190."

In a concurring opinion, Mr. Justice Jackson raises the question whether the doctrine of *Erie R. Co.* v. *Tompkins* extends beyond diversity cases.

In the case of *Sola Electric Co.* v. *Jefferson Electric Co.*, No. 45, 1942 Term, 87 L. ed. Adv. 150, it is held:

> "It is familiar doctrine that the prohibition of a federal statute may not be set at naught, or its benefits denied, by state statutes or state common law rules. In such a case our decision is not controlled by Erie R. Co. v. Tompkins, 304 U. S. 64, 82 L. ed. 1188, 58 S. Ct. 817, 114 A. L. R. 1487. There we followed state law because it was the law to be applied in the federal courts. But the doctrine of that case is inapplicable to those areas of judicial decision within which the policy of the law is so dominated by the sweep of federal statutes that legal relations which they affect must be deemed governed by federal law having its source in those statutes, rather than by local law. Royal Indm. Co. v. United States, 313 U. S. 289, 296, 85 L. ed. 1361, 1366, 61 S. Ct. 995; Prudence Realization Corp. v. Geist, 316 U. S. 89, 95, 86 L. ed. 1293, 1928, 62 S. Ct. 978, 48 Am. Bankr. Rep. (N. S.) 695; Jackson County v. United States, 308 U. S. 343, 349, 350, 84 L. ed. 313, 316, 317, 60 S. Ct. 285; cf O'Brien v. Western U. Teleg. Co. (C. C. A. 1st) 113 F. (2d) 539, 541."

In this case we are concerned with both substantive federal law and federal procedure, the subject of bankruptcy, particularly the reorganization feature thereof, comparable to which there is no state law, and in the procedural aspects of which no state counterparts are here available. Reorganization and the ordinary bankruptcy must inevitably be closely associated. Proceedings in state courts frequently precipitate bankruptcies. If the necessity of sometimes considering state laws may deprive or weaken federal jurisdiction in reorganization, or the mere fact that some state law, common or statutory, must be ascertained and declared by the bankruptcy court means that the state courts may better subserve the in-

terest of creditors than the bankruptcy courts, then the salutory purposes designed by the reorganization statute must inevitably be seriously restricted.

If questions of state law are presented, and in view of the foregoing cases it would seem that the law of bankruptcy is not state law, we readily appreciate the desirability of having a definite determination of such state law by the state courts. However, it has ever been necessary that the federal courts in exercising their proper jurisdiction at times ascertain and declare state law, both common and statutory. (See *Thompson* v. *Consolidated Gas Utilities Corp.*, 300 U. S. 55, 74; *Railroad Commission* v. *Los Angeles R. Corp.*, 280 U. S. 145, 152; *Concordia Ins. Co.* v. *School Dist.*, 282 U. S. 545, 553; *Portneuf-Marsh Valley Canal Co.* v. *Brown*, 274 U. S. 630; *Edward Hines Yellow Pine Trustees* v. *Martin*, 268 U. S. 458, 463.)

For the most part, the cases relied on in the respondents' briefs in which the federal courts declined to interpret and apply state law related to criminal statutes or ordinances of the states, questions of state taxation, or satutes relating to the official duties of state officials. For instance, the cases of *Beal* v. *Missouri P. R. Corp.*, 312 U. S. 45, and *Watson* v. *Buck*, 313 U. S. 387, (Md., 71) involved criminal laws of the states. *Chicago* v. *Fieldcrest Dairies, Inc.*, 316 U. S. 168, involved a municipal milk ordinance. *Texas* v. *Donoghue*, (302 U. S. 284) merely held that the Bankruptcy Court improperly denied the petition of the State of Texas to bring an action in the State Court against the debtor for the forfeiture of certain oil which the debtor had produced in violation of the conservation laws of the State of Texas. The decision of the Court pointed out that possession or control of the oil by the state court was not essential to its jurisdicion to entertain the suit proposed to be brought. The Texas

statute was considered to be penal in nature. Mr. Justice Cardozo, with whom the present Chief Justice joined, dissented upon the ground that the Federal Court was not called upon to lend its aid to the enforcement of the penal laws of the state.

In the cases of *Glenn* v. *Field Packing Company*, 290 U. S. 177, and *Lee* v. *Bickell*, 292 U. S. 415, referred to in the West Virginia Brief at page 71, the state questions presented were determined by the judgments of the federal courts and were merely held open to permit modification if at some later time the state court of final jurisdiction should decide otherwise. *Guaranty Trust Company* v. *Blodgett*, 287 U. S. 509, and *Hartford Accident & Indemnity Co.* v. *Nelson Mfg. Co.*, 291 U. S. 352, referred to in the West Virginia Brief on pages 70 and 71, respectively, merely announced the rule that federal courts are bound by the interpretation of state statute or constitutional provisions previously made by the state courts. The case of *Knights of Pythias* v. *Miles*, 255 U. S. 559, referred to on page 70 of the West Virginia Brief, we have been unable to find. We find in that book and at that page the case of *Knights of Pythias* v. *Overton*, which is a mere memorandum decision embodying no discussion of legal principles.

The West Virginia Brief (W. Va., 74) refers to *Toucey* v. *N. Y. Life Ins. Co.*, 1941, 314 U. S. 118. This case involved the application of section 265 of the Judicial Code inhibiting injunctions from federal courts to state courts. It is most significant to observe, however, that the inhibition of said section 265 of the Judicial Code does not apply to injunctions arising out of bankruptcy.

The case of *R. R. Commission* v. *Pullman Co.*, 312 U. S. 496, is referred to in each of respondents' briefs. This case involved the authority of the Railroad Commission

of Texas to issue a certain regulation. It was contended that such regulation, if valid under state law, would deny certain persons the equal protection of the laws. The authority of the Railroad Commission to issue any such order was questioned and had not been determined by the state courts. The federal court properly declined to pass upon the federal question prior to the consideration of the state question by the state courts for the reason that should the court of last resort of Texas decide that the Railroad Commission had no authority to make such regulation, then no federal question would be presented.

The case of *Thompson* v. *Magnolia Co.*, 309 U. S. 478, likewise is referred to in the Maryland and Wisconsin briefs. The question involved was one of Illinois Real Estate Law, whether a certain railroad right of way was an easement or fee interest carrying ownership of oil and gas. This Court concluded that the railroad's possession of the right of way afforded the basis for the exercise of the summary jurisdiction of the Bankruptcy Court to protect and control the estate and determine title, but that the case was of such a nature that it would be better for the Bankruptcy Court to consent to the submission of the question to the state courts for determination and to direct the Trustee to seek such adjudication in the state courts. Questions of real estate law are inherently questions of local law. Should any such questions arise in this proceeding, the precedent of *Thompson* v. *Magnolia Co.*, might be followed and the decisions of the state courts be sought by the direction of the reorganization court. Certainly that is a more practical disposition of such a problem than would be the refusal of the federal court to exercise its essential federal jurisdiction in bankruptcy merely because some questions of state law might arise. It would not be logical or reasonable to say that the state courts would better subserve the interests of creditors in reorganization merely because the State Courts could de-

cide such questions of state law as might possibly arise, when the State Courts have no jurisdiction to enforce the substantive bankruptcy laws, and in this case have no state reorganization statutes which would leave the proceedings in the state court in the status of equity receiverships, the flagrant inadequacy of which necessitated the enactment of Chapter X, and deny the creditors the salutory provisions of the federal law of corporate reorganization, Chapter X.

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The foregoing observations, it is believed, make unnecessary any consideration of section 3 of the Wisconsin brief entitled "The Public Interest" (Wis., 148). Counsel know of no principle of law or practice which suggests that there is any public interest which requires a court of bankruptcy either to decline to take jurisdiction, or to yield jurisdiction taken merely because the assets of the bankrupt estate may at the time be or may previously have been involved in state litigation.

**Segregation of Deposits by Contract Series**

In the Maryland brief (Md., 9) it is said that the statement in the briefs of the petitioners and the Securities & Exchange Commission that Fidelity kept accurate and separate accounts for the reserve funds of each series of contracts issued by it, and that the books indicated what securities were purchased with the reserve funds of each series is misleading. In the Wisconsin brief (Wis., 27) it is said:

> "* * * no attempt was made to designate what particular funds the securities came from in forwarding the securities to the various states, nor did the states themselves make any such allocation."

The record sustains the statements in petitioners' and the Securities & Exchange Commission briefs, and refutes the statements in the respondents' briefs.

C. E. Smith testified that ever since the first deposit was made to the series B and to the series D, the securities deposited in West Virginia were even filed in separate chests (601-602).

Since approximately 1933 every deposit with or withdrawal from the State of West Virginia was accompanied by a schedule showing the name and description of the security, the par value, the interest rate, the date of maturity, the market value and the fund to which it belonged (599).

C. E. Smith also testified that:

> "Actually the securities were earmarked on our records, that is, for a particular fund, irrespective of the place of deposit." (611.)

Smith also testified that if Fidelity had purchased a bond ten years ago from the funds of class A Contract Fund, the serial number of the bond and the amount could be ascertained (617).

The West Virginia Auditor, Mr. Sims, required Fidelity to put into the series B contracts a provision that moneys received by the company from the contract holders of that contract would be held by the company separate and apart from all other funds (660).

The annual audits of Fidelity were sent to the officials of the several states in which Fidelity did business. (643; 756-757). F. J. McNulty testified: "On our annual audit report the segregation of funds was shown (761). C. E. Smith testified that the books of Fidelity were always open for inspection by the officials of the states in which Fidelity was selling contracts, and that from time to time representatives of those states came to Wheeling and made examinations of such records (616).

The testimony of J. H. Schellhase shows that the books of the company contained a complete record of the moneys received by the company from each contract fund, and a record of all securities purchased by the company from the moneys of each contract fund, and that each security was earmarked on the records (581-582). Exhibits 50 to 55 show compilations from the records of Fidelity with respect to the deposits in Illinois, Maryland, Missouri, Ohio, Tennessee and Wisconsin, and particularly the contract funds to which the securities deposited in each of these states belonged.

Exhibit 64-C (650), a letter from the Banking Commission of Wisconsin, shows clearly that the Wisconsin authorities knew and understood that the securities belonged to particular funds. In the letter it is stated:

> "It was our understanding, in the letter received from the Home Office, that this matter of adjustment of various trust accounts would have been completed prior to this date."

When, during the hearing of this case in the District Court, counsel for Wisconsin objected to the use of the term "trust funds" and was confronted with a telegram from the Banking Commission of Wisconsin, he recognized that the term "trust funds" was correctly used (653-654).

The witness H. F. Young testified that the state examiners and officials evidenced a knowledge that there were such trust funds as A, B, C, D, etc., and that the respective state officials, when they accepted the securities, knew that they were coming from specific trust funds (653-655).

Other testimony relating to these matters will be found in the record at pages 331-332, 581-582, 584, 593, 600, 606-609, 628, 633-635, 643 and in Exhibits 59 to 67, inclusive.

**Respondents' Contention that Fidelity Officers Responsible for Institution of Chapter X Proceeding Seeking Some Benefit.**

In the Wisconsin Brief (Wis., 116) and in the West Virginia Brief (W. Va., 28, 29, 33), it is insisted that the petition shows that Fidelity was seeking to carve an equity for itself out of the assets which belong wholly to the contract holders; and apparently base their contention upon the statement in the petition that it is necessary that the rights of the contract holders be modified to an extent so as to enable the debtor to meet "its reserve requirements" and be able to comply with the Investment Company Act of 1940. Respondents interpret this representation as manifesting the intent of the debtor that the contracts be modified so as to permit Fidelity to have the $50,000 clear capital. The phrase "reserve requirements" might just as well, and probably did, refer to the reserve requirements of the Fidelity contracts. But, be that as it may, when Fidelity filed the petition, it submitted to the reorganization court and could not retract therefrom even if it later desired to do so (*Case* v. *Los Angeles Lumber Co.*, 308 U. S. 106). Certainly, even had Fidelity hoped to effect a reorganization which would enable it to have the requisite clear capital, such ambition would not invalidate the petition and, in view of the ruling of *Case* v. *Los Angeles Lumber Co.*, *supra*, would not be approved by the court.

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**Additional Comment upon the Respondents' Briefs, Severally**

**The West Virginia Brief**

On page 10 the West Virginia Brief refers to contract holders from West Virginia, Tennessee, Iowa, Michigan, and Ohio appearing in the District Court and ob-

jecting to the Chapter X proceeding. This reference purports to be supported by pages 287-288 of the record. These pages merely list the appearances, and the Tennessee creditors there named are the only creditors who yet participate in this cause. After investigation, the Ohio creditors reversed their position and supported the petition (832-833). The Wheeling, West Virginia, mass meeting has resulted in no active opposition to the petition (W. Va., 31).

The statement on page 27 of the West Virginia Brief that there is positive evidence that there can and will be no new capital is not correct. There is only evidence that thus far no offer of new capital has been procured.

The West Virginia Brief would argue that the decision in the *Marine Harbor* case is practically controlling upon the case at bar and would seek to draw a series of analogies between the two cases. In the *Marine Harbor* case the debtor had made previous efforts but the previous efforts there were under a state reorganization statute. Fidelity's previous efforts were purely voluntary and without the aid of a reorganization statute. It is said that in both instances state legislation was specially enacted to deal with the particular circumstances. There is no such special legislation in West Virginia and, if there is any applicable special legislation in any other state, it has not yet been brought to the attention of this Court. It is said that in the case at bar, as in the *Marine Harbor* case, there is only one class of creditors; namely, the contract holders. In the case at bar there are many classes of contract holders. The contention that those instituting the Chapter X proceeding in the case at bar were seeking some benefits, as a similarity to the *Marine Harbor* case, is not supported by the record. It is said that the need for prompt liquidation was seen in the Fidelity case. We have previously commented that West

Virginia counsel in the hearing insisted that there could be reorganization in the State Court though not in the Federal Court. We are at a loss to see how counsel can assert that any need for prompt liquidation was seen.

In addition to the fact that in the *Marine Harbor* case resort had been had to a state reorganization proceeding where there are no state reorganization procedures other than ordinary equity receiverships available in the case at bar, the differences between the *Marine Harbor* case and the case at bar are so numerous and clear as to make impossible any logical comparison.

On page 41 of the West Virginia Brief it is stated that the Investment Company Act of 1940 was "definitely intended to cover Fidelity". A part of the Investment Company Act of 1940 is Section 25 which expressly preserved the jurisdiction of reorganization under Chapter X. Though the West Virginia Brief did not discuss the eligibility of Fidelity for reorganization, this assertion most certainly refutes any assertion in the other briefs of respondents that Fidelity is an insurance corporation ineligible for reorganization under Chapter X.

While Section 25 of the Investment Company Act of 1940 recognizes that there might be voluntary reorganization of investment companies and that some reorganizations might result from other judicial proceedings than Chapter X proceedings, we fail to find in said Section 25 of the Investment Company Act any manifestation of any congressional intent that the fact that the investment company might have deposits with some of the states should exclude such investment company from reorganization under Chapter X, the jurisdiction for which was expressly reserved and protected by Section 25.

It is argued on page 43 of the West Virginia Brief that the Congressional intent of Section 29 of the Investment

Company Act, amending Section 67 (f) of the Bankruptcy Act, was designed for application only to straight bankruptcy rather than to reorganization. Section 102 of Chapter X makes the provisions of the other chapters of the Bankruptcy Law applicable to Chapter X where not inconsistent therewith.

On page 57 of the West Virginia Brief it is said that officials of six states are respondents and have requested this Court that they be permitted to continue their prior state proceedings to liquidate Fidelity. This proceeding is to reorganize Fidelity. The State Court proceedings, certainly so far as originally instigated in West Virginia, were for the purpose of reorganizing Fidelity. It is not believed that the desire of the states to liquidate Fidelity in the State Court proceedings, originated for the purpose of there reorganizing Fidelity, should appeal very strongly to this Court when the change from the desire to reorganize to the desire to liquidate seems to have been prompted solely by the fact that the only court, the reorganization court, which can effectively reorganize Fidelity has taken jurisdiction of its assets.

On page 80 of the West Virginia Brief it is said that in the various states, after the claims of domestic creditors are satisfied, a surplus of assets remaining will be remitted to the domiciliary receivers. Petitioners have not doubted this principle of law but petitioners still insist that, if there is any reasonable prospect of any such surpluses being remitted, if the creditors in other states entitled to participate therein are to receive the benefit of any such surplus, their interests will have to be represented in such states in order to make certain that such states do not so administer and distribute such assets as to consume all of them.

The West Virginia Brief would make much of the assertion that the proposed administrations in the various

state courts are conducted by the Attorneys General of the several states. Although six states are actively participating as respondents in this cause, there is only one attorney general, the Attorney General from Wisconsin, actually actively participating. An examination of the record will show no active participation by the Attorney General of West Virginia beyond consent to the use of his name on briefs and pleadings.

On page 84 of the West Virginia Brief reference is made to the case of *Reading Hotel Corporation* v. *Protective Committee*, 89 F. (2d) 53, as sustaining the contention that liquidation should promptly ensue in the State Court proceeding. The *Reading Hotel Corporation* case was a case for reorganization in the Bankruptcy Court, and the reorganization was approved. The point in issue was the objection by the stockholders to their exclusion from participation in the reorganization plan.

On page 90 in the West Virginia Brief it is stated that on October 10, 1941, the Trustee prepared and submitted to the Court a partial report under Section 167, and on April 13, 1942, a further partial report,* and complaint is made that these reports have not been submitted in any form to the contract holders. It would hardly be expected that during the litigation relating to the basic jurisdiction of the reorganization court the expense of submitting any such reports to the creditors would be incurred or that the information thereof would be of any aid to the creditors. (See *Continental Illinois, etc., Co.* v. *C. R. I. & P. R. Co.*, 294 U. S. 648.)

On pages 91 to 96 of the West Virginia Brief the points of superiority of the Chapter X proceedings over equity

(*) This report is not in the record before this Court. It has been filed in the District Court and is an official paper in this cause. In view of counsels' reference to this report it is printed in the Appendix hereto. Therein the Trustee reports that reorganization beneficial to the creditors can be effected.

receiverships raised in Petitioners' Brief are discussed by West Virginia counsel. We shall not re-discuss all of these points but note that under Point (1) the West Virginia counsel refer to the efficiency of the reorganization under general equity proceedings in State Courts. Some of these reorganizations may not have complied with the standards of fairness which Chapter X prescribes.

Under Point (2) West Virginia counsel say that the petition was filed at the instance of the "old management group" of Fidelity. It matters not by what management group the petition was filed. There is no management group for conducting the proceeding under Chapter X. The Court, with the aid of the disinterested Trustee, conducts the reorganization proceeding under Chapter X.

When the Petitioners' Brief was prepared, counsel for petitioners were not then aware of the order of the Circuit Court of Kanwaha County of May 26, 1941, directing that the form and manner of submission by the State Receivers to the contract holders of any plan of reorganization and rehabilitation of Fidelity should be submitted to the court for approval before such submission. The fact that such order was entered by the Circuit Court of Kanawha County does not change the observation of Petitioners' Brief, however. Such order was not issued pursuant to any state statute requiring such procedure comparable to Sections 174 and 175 of Chapter X, and the order relates only to the submission of plans by the Receivers. It does not exclude the submission of plans by some management group or creditors' committee prior to approval by the court, and the court might at any time rescind this order, even as it applies to the Receivers.

As was anticipated in Petitioners' Brief, counsel for the respondents would attempt to meet the insufficiency of the ordinary equity receivership by saying that they will

cause to be done in the state courts voluntarily all that Chapter X requires by statute to be done.

With reference to Point (10) (W. Va., 94), Petitioners do not contend that Chapter X has made illegal voluntary reorganization without judicial aid or with the imperfect aid of courts operating without reorganization statutes. Petitioners do insist that the factual situation presented in the case at bar makes reorganization possible only through the Chapter X proceeding, and it is hardly consistent for the respondents to insist that there can be reorganization in the several state court proceedings while at the same time they insist that liquidation and distribution is inevitable and (W. Va., 57) are requesting this Court that they be permitted to continue their prior state proceedings to liquidate Fidelity.

Under Point (11) (W. Va., 95), West Virginia counsel say that those in charge of the state proceedings are state officials elected to their offices by the contract holders in the respective states. Nevertheless, the West Virginia State Auditor who instigated all of the State proceedings collaborated with representatives of Fidelity in endeavoring to hold assets of Fidelity in statu quo pending the accomplishment of voluntary reorganization, which, so far as the record shows, involved no plan other than one to sacrifice the interests of creditors in order to preserve some value for stockholders contrary to *Case* v. *Los Angeles Lumber Company, supra.*

The West Virginia Brief (W. Va., 96-100) and Appendix (W. Va., 116-125 and 130-134) contain references to and discussions of many matters and things which are not contained or referred to in any way in the record. Counsel for the petitioners are loathe to depart from the record, but these references demand some departure herein.

Counsel for the petitioners deny that the order of the Circuit Court of July 22, 1942 (268-270), contemplated liquidation of securities beyond such liquidation as was necessary for conservation. (See petition for modification and exhibits (271-285).)

At the informal hearing before Judge Parker upon the motion for the stay of the mandate to permit the filing of the petition to this Court for certiorari three of the counsel for respondents who represented themselves as a committee acting for all of the respondents' counsel complained of the delay in obtaining proofs of claims occasioned by the jurisdictional controversies and complained that under the order of the District Court the Trustee was not permitted to give to the various state officials the several lists of creditors by states. Judge Parker very correctly was of opinion that no harm would be done if proofs of claim were taken which might be utilized in the Federal Courts or in the several State Courts as the disposition of this case by this Court might make appropriate. Accordingly, paragraphs 5 and 6 of the order of July 22, 1942, were entered. Section 6, as well as Sections 1 and 3, was originally suggested to give the powers or rights to each state court having judicial supervision or control of cash or other securities deposited by Fidelity, but, upon the suggestion of one of the respondents' counsel that there were states in which there was no state court having jurisdiction but there were state officials having jurisdiction, there was added to these sections the phrase "or state official" having jurisdiction. The State Auditor of West Virginia has no statutory jurisdiction to give notice to contract holders or to accept proofs of claims. The Circuit Court of Kanawha County, West Virginia, declined to approve any forms of proofs of claims or to enter any order of any character in the West Virginia State Court proceeding un-

til the question of basic jurisdiction, now under consideration by this Court, should be determined. Counsel for the petitioners deny that the West Virginia State Auditor has any statutory authority to issue any such administrative order as is referred to at the bottom of page 133 of the West Virginia Brief in connection with the forms of proofs of claims. Counsel for the petitioners hope that these proofs of claims, not for liquidation and distribution of assets but for the determination of the interests of the several creditors, may be usable in the District Court for purposes of reorganization; or that, if this Honorable Court should be of opinion that jurisdiction under Chapter X has not been sustained, that such proofs of claims might be usable in the State Courts. Counsel for the petitioners deny that such proofs of claims have been sent out by the Auditor of West Virginia in keeping with the order of the Circuit Court of July 22, 1942, for the reason that said order contemplated the submission of such proofs of claims only through action of the State Courts in states in which there were State Court proceedings and not by administrative officials invested with no powers to adjudicate claims in states in which there were such State Court proceedings.

Counsel for the petitioners are not advised of the various activities engaged in by representatives of the several states as discussed in the several paragraphs in the Appendix to the West Virginia Brief dealing with the "digest of depository laws and trust indentures of the fifteen states where Fidelity made a deposit and status of state court proceedings pending therein" (W. Va., 116-125).

West Virginia counsel say (W. Va., 99) that no objection to the procedure of taking proofs of claims has been made by any contract holder. Naturally, no contract holder has complained because the letter by which said proofs of claims were sent out, as well as said proofs

of claims (W. Va., 130), show, in keeping with the understanding had from Judge Parker, that "should it finally be held that the Federal Court has sole jurisdiction of the proceedings all proofs of claim received will be turned over to the proper officials thereof."

Said proofs of claims are prepared for filing with "H. Isaiah Smith and Ross B. Thomas, West Virginia State Court Receivers, as such, and *as agents of Edgar B. Sims,' Auditor and Ex Officio Insurance Commissioner* • • • ." (W. Va., 131.) Whether or not H. Isaiah Smith and Ross B. Thomas have undertaken to act as agents of Edgar B. Sims, Auditor, counsel for the petitioners do not know, but counsel for the petitioners do know that said Smith and Thomas, West Virginia State Court Receivers, are not agents of Edgar B. Sims, Auditor, etc., by virtue of their appointment as receivers. In the hearing in the District Court H. Isaih Smith testified that he regarded himself as an arm of the Circuit Court of Kanawha County (822; Rep. Tr. 2356).

**The Wisconsin Brief**

On page 40 of the Wisconsin brief, it is said that Mr. Fleming, the Debtor's attorney who presented the petition, "withdrew during the course of the trial and was replaced by Mr. John Ray on September 17, 1941." Page 662 of the Record is referred to as the authority for this observation. Counsel for the petitioners see nothing whatever on page 662 which would even lend color to such statement, and say that there is nothing in or outside of the record substantiating this statement. It is true that Mr. Fleming was taken ill during the hearing, and that Mr. Ray was engaged principally for that reason. It is also true that Mr. Fleming has not participated actively in court proceedings since that time. Mr. Fleming is, however, yet counsel for the Debtor, and after the de-

cision of the Circuit Court of Appeals, but prior to the presentation of the petition for rehearing therein, Mr. Holt was also engaged on behalf of the Debtor. The order of the District Court approving the employment of Mr. Ray and the order of the Circuit Court approving the employment of Mr. Holt are printed herewith in the Appendix. Mr. Fleming has conferred with other counsel for the Debtor as late as the day upon which petitioners' brief was filed herein, and even thereafter has conferred with counsel representing the S. E. C. On page 140 of the Wisconsin brief, observations, wholly without record support, are made which would at least carry implications imputing doubt with respect to the employment of Messrs. Ray and Holt. These implications may be discussed in argument.

On page 41, it is said that the State Auditor renewed Fidelity's license as an insurance company on April 1, 1941, to expire March 31, 1942. The affidavit of F. J. McNulty (231-232) shows that Fidelity applied for such license and sent its check to the State Auditor for that purpose, but that the application was returned by the Auditor, the check was not cashed but was returned by the Auditor, and said license was not issued. This is further confirmed by the stipulation of counsel made in the Circuit Court (237).

On page 45, it is stated that licenses were issued to twenty salesmen of Fidelity as life insurance salesmen. The statement of the State Auditor (462) refutes this statement, as does the testimony of A. L. King (701).

On page 46, it is said that Fidelity, in fact, issued life insurance policies and assumed insurance risks. The only record basis for any such statement is that provided by the references to the riders to be attached to the Series B contracts containing the insurance features made in the

petition to the Circuit Court for remand (219), and in the stipulations of counsel entered into in the Circuit Court (237). Even if for purposes of argument it be assumed that such riders constituted the assumption of life insurance risks, which counsel for the petitioners do not admit, there is no evidence whatever that Fidelity issued life insurance policies.

Though the letter to the Banking Commissioner of Wisconsin, of December 21, 1940, stated by way of recital that the proposed amendments to the Fidelity charter would enable Fidelity to write insurance contracts, there is no statement that Fidelity had otherwise qualified, and no effort was made to qualify Fidelity as an insurance company in Wisconsin.

Counsel invite particular attention to the concession on page 64 of the Wisconsin brief that Fidelity was not an insurance company prior to December 31, 1940. This concession if acceded to by all respondents greatly simplifies the question of Fidelity's eligibility for reorganization, and makes that question rest solely upon the effectiveness of the attempted transformation on and after December 31, 1940.

In this connection, on page 96 of the Wisconsin brief, it is conceded that Fidelity could not change its classification for the purpose of avoiding an involuntary petition. Following the philosophy of the *Marine Harbor* case, petitioners' counsel most earnestly insist that the unsuccessful efforts of Fidelity to transform itself into an insurance company do not estop it from filing a voluntary petition.

The references in the Wisconsin brief to Fidelity's "unconditional license" as an insurance company are astounding (Wis., 67 and 69). Even the Wisconsin brief (Wis., 65) states that such license "was issued pursuant to an informal understanding with the Insurance Com-

missioner that it would enter into no new contracts of any kind until he had advised the company that it might do so", and that the West Virginia Auditor had testified that he had issued the license "in order that the Debtor would have authority to receive payments under its outstanding contracts." The record is clear and undisputed that this so-called license was but a sham. (See Record References, page 9, Petitioners' Brief.) In this same connection, it is interesting to observe that in the West Virginia brief (W. Va. 33) it is argued that Fidelity could never comply with the Investment Company Act of 1940, because the company was required to have a clear capital of $50,000 in order to so qualify. It is also true that in order to qualify as an insurance company in West Virginia, and to become entitled to have a license as an insurance company from the State Auditor under Section 1, Article 3, Chapter 33 of the West Virginia Code (Petitioners' Brief, Appendix, 69), it was necessary that Fidelity have "at least $200,000 cash capital fully paid up or a like amount of cash surplus * * *." This requirement, undoubtedly, made the actual qualification by Fidelity as an insurance company at the time impossible. It may seriously be questioned whether, even had the State Auditor issued Fidelity a license as an insurance company without qualification, Fidelity would in reality have been a licensed insurance company. The Auditor had no power or authority to issue any such license unless Fidelity was so qualified, and Fidelity knew of these requirements as well as did the Auditor.

On page 68, it is argued that it cannot be questioned that the so-called riders relating to the Series B contracts constituted insurance contracts. In the absence of the development of a more complete record with respect to these riders, petitioners' counsel need not express an opinion as to whether or not the form and substance of these riders were such as to occasion the as-

sumption of some character of insurance responsibility if such riders were legally issued. On the other hand, it may seriously be questioned whether public policy permits the giving of validity to purported insurance undertakings by a company not in fact licensed. Furthermore, for purposes of reorganization, the determination of the rights and interests of creditors, even though some technical legal obligation may have been incurred, it is very doubtful whether such undertakings amounted to engaging in the insurance business in any practical sense, in view of the fact that the existing plan of carrying the insurance with the Lincoln National Life Insurance Company was not in any manner changed.

The Wisconsin brief concedes the power of Congress to provide that corporations now ineligible for bankruptcy be eligible therefor (Wis., 77). The brief also concedes that face-amount certificate companies are amenable to bankruptcy, and that it was not necessary for the Bankruptcy Act to make them so amenable (Wis., 88). The brief (Wis., 85-89) also recognizes that the definitions of investment companies as provided by the Investment Company Act of 1940 would include all life insurance companies were it not for the express exception of life insurance companies from said definitions made by the Investment Company Act, Section 3(c) (3) and Section 2(a) (17). The brief also concedes that, had face-amount certificate companies been excluded from bankruptcy prior to the enactment of the Investment Company Act, then said Act would have made such face-amount certificate companies amenable to bankruptcy (Wis., 89). The inescapable conclusion from these concessions is, therefore, that even if Fidelity prior to the enactment of the Investment Company Act of 1940 might have been classified as an insurance company rather than as an investment company, Fidelity is, nevertheless, an investment company, a face-amount certificate com-

pany of the installment type, unless it comes within the exclusionary definition of an insurance company as provided by the Investment Company Act, Section 2(a) (17). It is obvious that the activities of Fidelity Assurance Association, even after the charter amendment of December 31, 1940, and even if it be conceded for purposes of argument that Fidelity's license as an insurance company was valid and unconditional, do not bring Fidelity within the definition of an insurance company as provided by the Investment Company Act.

Despite the foregoing concessions and the inescapable conclusion, the Wisconsin brief would argue that there was no congressional intent on the part of Congress that the definitions of investment companies and insurance companies, as found in the Investment Company Act of 1940, should have any bearing on the previously established judicial definitions of an insurance company for purposes of bankruptcy within the meaning of Section 4 of the Bankruptcy Act. In view of the express amendments to the bankruptcy law made by Section 29 of the Investment Company Act, and the express reservations of powers of courts of the United States with reference to reorganizations as contained in the Bankruptcy Act of 1898, as amended, made by Section 25 (d) of the Investment Company Act, this contention is plainly unsound, indefensible and untenable.

The Wisconsin brief (Wis., 92) correctly says that Fidelity procured the charter amendment as an insurance company in an effort to avoid the Investment Company Act. Had Fidelity become in fact an insurance company, it would have avoided the Investment Company Act. If then Fidelity did become an insurance company as the respondents insist, why did it not immediately resume its annuity contract business as it had formerly been conducted, since no one denies that life insurance

companies in many states may issue annuity contracts! Neither the $50,000 capital requirement nor the 7% loading charge provisions of the Investment Company Act would have been applicable to Fidelity as an insurance company, excluded from the provisions of the Investment Company Act, and these were the provisions of the Investment Company Act which it is said made it impossible for Fidelity to operate thereunder.

The Wisconsin brief (Wis., 84) concedes that if a corporation engages in more than one activity, each of which is within its charter powers, it is proper that the court look to the business actually done in determining the character of the corporation.. This is a flat concession by Wisconsin counsel of the correctness of petitioners' position.. Two charter powers of Fidelity were involved, one the issuance of annuity contracts, which power Fidelity not only had but exercised for many years and retained under the charter amendment of December 31, 1940; the other, the power to issue contracts of insurance, which was not had even formally prior to December 31, 1940, and which was not had in fact even thereafter, and which was not exercised. Admitting for purposes of argument, that Fidelity had both of these powers after December 31, 1940, by counsels' own concession it is necessary and proper that the Court look to the business activities in order to determine the proper classification.

The Wisconsin brief (Wis., 109) suggests that if an orderly liquidation of the Debtor's assets is to be considered reorganization, such must be limited to cases where the debtor can make some showing of "going concern value." Fidelity has a large number of customers, it has a well selected portfolio of investments, it has good will (632), and the respondents even after the decision in the Circuit Court by their activities have recognized

the value of the assets of Fidelity as a whole as distinguished from the value which they would have if they were liquidated by lots or parcels through independent activities and without concerted management (281, 282; W. Va., 97; Md., 68, note 11).

The Wisconsin brief (Wis., 113) says that the cases *In re Porto Rican American Tobacco Company*, 112 F. (2d) 655, and *Continental Insurance Company* v. *Louisiana Oil Refining Corporation*, 89 F. (2d) 333, and other cases cited in petitioners' brief (Page 42), are not helpful on the issue of good faith. The respondents argue that good faith is lacking because there cannot be complete rehabilitation. These cases show that complete rehabilitation is not the only legal method of reorganization. If it be assumed, which petitioners' counsel deny to be the fact, that there could be no rehabilitation, but these other methods of reorganization are available, most certainly the existence of such other methods of reorganization strongly support the probability of reorganization and tend to rebut the contention of the respondents that there was want of good faith because there was no probability of reorganization.

On page 121 of the Wisconsin brief, it is insisted that it is unreasonable to expect that there can be reorganization because the field offices of Fidelity have been closed and its sales force has been completely dissipated. It must be remembered that the purpose of reorganization of an insolvent company is not to maintain the organization of such company unless it be required for the best interests of the creditors, but is to protect and promote the interests of the creditors however that may be done.

The statement of the Wisconsin brief that no witness was able to give a hint as to the manner in which reorganization could be effected (Wis., 122-125) is incorrect. The West Virginia State Auditor suggested

the organization of a mutual company. The witness D. A. Burt thought that upon a proper set-up new capital might be available. The witness Hubert F. Young suggested the possibilities of merger with another company or organization as a mutual company, the activities of which might include both annuities and insurance. The witness Latta referred to the possibilities of deferred orderly liquidation. (See Record References, pages 44 and 45, Petitioners' Brief.)

On Page 126 of the Wisconsin brief it is stated that if Fidelity was not an insurance company on the day the petition was filed "it seems obvious that it could not reorganize itself as such under Chapter X." Petitioners' counsel know of no provision of Chapter X or of any other principle which would prevent the reorganization court in a Chapter X proceeding from approving a plan of reorganization which would result in the reorganized company's becoming an insurance company. That insurance companies are not eligible for reorganization certainly does not argue that a company eligible for reorganization may not be reorganized into an insurance company.

That some courts have criticized the methods by which Fidelity previously operated, as stated in the Wisconsin brief (Wis., 129), certainly does not mean that the former methods of Fidelity which were criticized must be embodied in the plan of reorganization. The court and the independent trustee, with the assistance of the Securities and Exchange Commission, formulate the plan of reorganization, not the debtor.

On page 131 of the Wisconsin brief, it is argued that the state authorities would not likely permit the operation of the Fidelity plan in their several states hereafter. Yet, in endeavoring to show that Fidelity was a life insurance company because life insurance companies may issue an-

nuity contracts, the respondents do not question the fact that sound and legal annuity contracts can be made and executed.

On Page 139 of the Wisconsin brief, it is charged that the Trustee is not disinterested because the Trustee has been active in assisting in the defense of the basic jurisdiction of the District Court and is one of the petitioners in this Court. That the trustee must be disinterested refers to its business and financial interests at the time of the trustee's appointment and during the course of the proceeding. Most certainly the qualification of disinterestedness does not mean that the trustee must be indifferent towards a proceeding which the trustee believes to be for the best interests of the creditors whose rights and interests the trustee has been appointed to preserve and protect. The mere fact that the trustee may expect to receive, and may receive, reasonable compensation for its services, certainly does not take the trustee out of the classification of disinterested persons.

**The Maryland Brief**

The Maryland Brief (Md., 14) says that the statement in Petitioners' Brief (Petitioners' Brief, 6) with respect to the creation of a reserve fund for the particular class or series of contracts from payments made on contracts of that particular class or series is incorrect. Counsel for the petitioners have taken said statement almost verbatim from the findings of the District Court (180). It is believed that the statement is fully sustained by the record. Be that as it may, the Maryland Brief (Md., 14) concedes that such particular reserve funds were to be kept separate and solely for the discharge of liabilities under contracts of Series B and D and, even if it be granted for purposes of argument that the contract provisions of other series were not quite so explicit, the legal results

with respect to Series B and D cannot be ignored. The reserve funds of Series B and D represent a very substantial part of Fidelity's assets. The Maryland Brief (Md., 65 and 66) suggests that the state laws do not expressly require segregation by series funds and would imply that the state laws exclude the creation or recognition of more than one fund. Petitioners' counsel do not believe that any statute involved can be reasonably argued to make improper the segregation of the deposits by contract series if the contracts so contemplate or provide.

The Maryland Brief (Md., 9) says that the contention of the petitioners and the Securities and Exchange Commission that on its books Fidelity kept accurate and separate accounts for the reserve funds of each series of contracts issued by it and that the books indicated what securities were purchased with the reserve funds of each series is misleading. Counsel have heretofore presented some of the many statements in the record demonstrating the accuracy of the statement that on the books of Fidelity the funds and investments were kept separate. Of course the actual bonds were not despoiled by writing upon the face of the securities the funds to which they belonged. That is not the customary way for the identification of securities. The Maryland Brief (Md., 9) does concede that during the latter years and after the entry of the injunction order in December, 1938, Fidelity made efforts to segregate its state deposits by series. Even if it be admitted for purposes of argument that Fidelity's segregation of funds was not perfect, that fact should not make it unnecessary that the segregation in so far as perfect should be recognized in this proceeding.

In the Maryland Brief (Md., 13) it is stated that the petitioners erred in saying that the reserve funds of contract Series A, B, C, and D are solvent. Maryland counsel may not be bound thereby but the authority for this

statement by petitioners' counsel is the statement of the respondent West Virginia Auditor as contained in his telegram to the Banking Commission of Wisconsin (1215, 311), a telegram similar to which was sent to some sixteen states on the 11th day of April, 1941, the day on which the West Virginia State Court proceeding was instituted.

Counsel for the petitioners recognize that there may be many different modes or bases by which the solvency or insolvency, and the degree of insolvency, of Fidelity may be computed. Counsel for the petitioners adopted the basis recognized generally during the hearing of this cause. Various computations and adjustments are made in tables presented in the West Virginia Brief, and the Maryland Brief insists that Fidelity is less than 90% solvent. The basis adopted by the Circuit Court of Appeals and used by counsel for the petitioners may be said to be as typically illustrative as any other basis that might have been selected. Upon any basis, from the common knowledge of the general appreciation of securities for the past two years, it may safely be assumed that the securities of Fidelity have materially increased in value between the dates as of which the various figures in the record were taken and the present time.

## CONCLUSION

In the foregoing argument counsel for the petitioners have not undertaken to reply in detail to all of the arguments and contentions in the several briefs of the respondents. Counsel have not even mentioned some of the arguments and many of the errors and inconsistencies thereof. Counsel have endeavored to correct some errors in statement, some errors in interpretation of cases, and to demonstrate the fallacies of the principal arguments in the several briefs of the respondents.

The fact that there are three briefs on behalf of the respondents has made it impracticable for counsel to present their reply argument in a manner as orderly and well arranged as counsel would otherwise have desired.

It is believed that this Reply Brief has demonstrated the unsoundness or the inapplicability of the principles relied upon by the respondents, and it is again urged that the order of the United States Circuit Court of Appeals for the Fourth Circuit should be reversed and that the order of the United States District Court for the Southern District of West Virginia should be affirmed.

Respectfully submitted,

JAMES R. FLEMING,
JOHN V. RAY,
HOMER A. HOLT,
*Counsel for Fidelity Assurance Association, Debtor.*
T. C. TOWNSEND,
HILLIS TOWNSEND,
*Counsel for Central Trust Company, Trustee for Fidelity Assurance Association.*

Charleston, West Virginia,
February 6, 1943.

# APPENDIX

**Part II of Trustee's Report, April 13, 1942***

In the Matter of ) In Proceedings for
FIDELITY ASSURANCE ) Corporate Reorganization.
ASSOCIATION, *Debtor.*) No. 4514.

## REPORT OF CENTRAL TRUST COMPANY, TRUSTEE, AS PROVIDED BY ORDER OF FEBRUARY 25, 1942, DESIGNATED AS "PART II" OF TRUSTEE'S REPORT UNDER SECTION 167, CHAPTER X.

*To the Honorable Ben Moore, Judge of the District Court of the United States for the Southern District of West Virginia.*

The Central Trust Company, Trustee, respectfully reports to the Court as follows:

The Court's attention is directed to the report of the Trustee filed herein on October 6, 1941, (designated as Part One) which was filed pursuant to the requirements of Section 167, of Chapter X, which contained, among other things, information concerning the following:

A. Nature and history of the debtor's business.

B. Statement of assets and liabilities of the Company as of June 6, 1941, broken down as to the several contract funds.

*This report is not a part of the Record. It is referred to at Page 90 in the West Virginia brief. For that reason it is presented herewith.

C. Schedules showing the location and value of the Company's assets. Also schedule showing assets on deposit in the various states and the liabilities to contract holders by states.

D. Schedules showing rating by classification of securities owned by the Company.

E. Various tables, charts, and brief statements concerning numerous other matters such as tenure of office of officers and directors, the method employed in making investments, detailed information concerning investment securities sold by the Company, and a list of other items on which the Trustee would report after a detailed examination and audit.

The Court's attention is also directed to the report filed herein by the Trustee on August 5, 1941, which contained, among other things, the following:

A. A list of securities delivered to the Trustee.

B. A list of the holders of the common stock of the debtor.

C. A list of the holders of the preferred stock of the debtor.

D. A list of the contract holders which contains the following information:

(a) Contract number.

(b) Name and last known address of the contract holder.

(c) Actuarial reserve. (This figure supports the reserve as shown on the balance sheets.)

(d) Cash liabilities.

(e) Loans to contract holders.

(f) Additional credits. (This applies only to Series "B" contract holders.)

E. Balance sheets showing the assets and liabilities of the debtor as of June 6, 1941.

F. A schedule showing the par value, book value, and market value by funds of all securities owned by the debtor as of June 6, 1941.

Although your Trustee has refrained from incurring the expense of an audit which will be necessary before a full and complete report can be made on the items set forth on Page 64 of the Part One Report, your Trustee submits the following as a continued partial report under Section 167 of Chapter X.

1. Your Trustee is of the opinion that during this proceeding it is desirable to continue the operation of the debtor's business to the extent and in the manner followed by the Trustee since the commencement of the proceeding; i. e., servicing the securities in the possession of the Trustee, servicing the portfolio, with recommendations, as they appear proper, to the state custodians of assets; the conservation of the estate in the manner and according to the established rules for managing trust estates; maintaining and operating the home office to the extent necessary for preserving and caring for the records of the company with the view of having such office and records readily available to any plan of reorganization that may be effected; collecting the payments made by contract holders under the order of June 14, and maintaining the escrow accounts therefor; making refunds, upon receipt of proper applications, to contract holders of payments made by them since June 6, 1941.

2. The method adopted and followed by your Trustee for servicing the investment portfolio of the debtor is described in considerable detail, with examples, in the Trustee's application for interim allowances filed herein on March 10, 1942. Briefly, the method is as follows: In collaboration with the firm of Standard and Poor's Corporation, nationally recognized authority on statistical analysis, forms were designed and prepared for statistical reports on each security in the portfolio. In the beginning the said Standard and Poor's prepared an analysis of each security in the portfolio and these analyses are kept up to date by a revision of the analysis each time the issuing company releases a statement. Copies of the analyses are furnished to your Trustee and to Hubert F. Young, former investment officer of the debtor, now employed by the Trustee, who in turn presents to the Trustee his report and opinion concerning the security, based upon the said Standard & Poor's report and upon such other information as the said Young gathers at his New York office. With the reports of the said Standard and Poor's and the said Young before it, your Trustee then decides, through its investment committee consisting of Messrs. Dickinson, Picklesimer and Payne, whether the security in question should be held, sold, exchanged or converted, or whether any other action should be taken with respect thereto such as giving consent or filing objection to plans of corporate reorganizations, etc. Immediately after reaching a decision the Trustee notifies all state depositories holding said security in question of its decision and recommendation.

After making this detailed analyses of the securities portfolio the Trustee is of the opinion that the best interest of the contract holders and other parties in interest can be best served through some form of reorganization or by slow and orderly liquidation.

The estate of the debtor may be divided generally into four classes of property:

(1) Securities having a ready market value and convertible into cash immediately,

(2) Securities for which there is only a limited market, but which can be sold without great difficulty or delay,

(3) Securities which can be sold only in small blocks and which must be sold with considerable caution in order to prevent depressing the market therefor,

(4) Real estate.

The analyses by your Trustee of the securities contained in the portfolio disclose that only approximately fifteen per cent of the securities can be classified as having a ready market. This does not necessarily mean that there is no market for the remaining securities, but as a group they would require careful handling, and if sold should be offered in small blocks on a favorable market in order to prevent a depression of the market with consequent loss in prices realized. A study is being made of the real estate owned by the debtor, and recommendations regarding the same will be made as soon as such study is completed.

Your Trustee feels that in view of the character of the investments in the securities portfolio that any procedure requiring rapid liquidation such as would be required in straight bankruptcy would tend to dissipate the assets of the Company, thereby causing needless loss to the creditors.

3. Your Trustee at this time is unable to present any details of a plan of reorganization due to the fact that there are certain important matters that must be decided

upon from a legal standpoint before a plan can be worked out and submitted. Your Trustee reports, however, that there has been several suggestions made as to the kind of business into which the Company may be reorganized into a going concern. Some of these suggestions were made during the hearing before Your Honor beginning August 5, 1941 and concluded October 10, 1941, together with additional suggestions made to your Trustee. Among the suggestions are, (a) insurance company, (b) investment trust company, (c) mutual savings and loan company, (d) face amount certificate company with insurance provisions.

Your Trustee reports as one possibility that will lend itself for consideration for reorganization is that the assets could be placed in a management trust. This, your Trustee believes, would be profitable to the general interest, irrespective of the interest of the individual beneficiaries (present contract holders) as the same may be ultimately determined. Such a trust could be managed in a way so as to dispose of securities in an orderly manner with the income in the form of dividends and interest derived from the securities accruing to the benefit of the creditors. A feature could be incorporated in the trust whereby beneficiaries (the present contract holders) could borrow a designated percentage of the amount of their equities which could be adjusted from time to time as changing conditions would warrant. This would give some relief to contract holders who are in immediate need of cash, and at the same time provide a means of keeping surplus cash invested. The present securities portfolio has a number of securities that have a high interest yield with safety of the principal being somewhat questionable. In such instances certainly a management trust would be beneficial to the creditors as by careful management these securities could be gradu-

ally sold and the proceeds reinvested in other securities of a type conforming to the kind usually purchased and owned by trust estates.

4. Your Trustee is not able to report in detail as to alleged irregular practices of the former management which may render those participating therein liable to debtor in damages. Counsel for the Trustee is now engaged in making a detailed study of this question.

5. Before the rights and priorities of contract holders can be determined, and before the details of a plan of reorganization can be perfected, it will be necessary, among other things, to have questions such as the following adjudicated by the Court:

While the Company was operating, loans were made from one contract series fund to another. This created a situation of setting up on the Company's books debtor and creditor funds. Will these loans between contract funds be considered as a prior claim on the assets of the particular debtor fund? Or, will they be considered as sharing on the same basis as other creditors? Or, will they be considered as common creditors and repaid only after all other creditors are paid? The decision on these important questions will be far reaching in its effect upon the contract holders in the funds involved.

A very complicated situation exists in the matter of the Company's deposits with the various states. The clearest presentation of this condition can be achieved through a combination of the following explanation and illustrations:

As pointed out in the Part One Report, there is no uniformity in the statutory requirements of the various states with regard to requiring deposit of securities to be held by designated state agencies to insure the liabilities

to contract holders in each particular state, or as prerequisites for qualifying to do business in the states.

As was also pointed out in Part One of this report, the Company has outstanding six series of contracts: (1) Special Income; (2) Special Annuity; (3) Income Reserve (Usually referred to as Series "A"); (4) Series "B"; (5) Series "C"; and (6) Series "D".

The Company maintained separate records for each of the six series. Money collected from the contract holders of any one particular series was used to purchase securities as investments specifically intended for that series fund, and were so recorded on the books of the Company. Your Trustee has found, however, that in many instances situations like the following occurred:

An increase occurred in the liability to Series "B" contract holders in State "X". For one reason or another, acceptable securities which had been purchased for that fund were not immediately available. The Company thereupon deposited securities purchased for the Series "A" fund because they were on hand at the time. It is important to remember that the securities deposited were purchased with money collected from Series "A" contract holders *everywhere* and not solely with money collected from contract holders in State "X". This is but an example of similar occurrences which have involved all series of contracts in one manner or another, with the possible exception of Series "C".

Summing up, the following involved condition exists:

Certain securities purchased with money collected from the contract holders of one or another series *everywhere* have found their way into the hands of one or another particular state; and frequently to cover the liability in an entirely different series.

The questions growing out of this situation are:

1. Shall the assets, owned by the Company, be considered as securing the contract liabilities of all contract holders alike without regard to the series of contracts owned and also without regard to the fact that the assets were deposited in the various states?

2. Or, shall the assets, as carried on the books of the Company by contract series, be considered as securing the contract liabilities to *all* contract holders of that series *everywhere*, without regard to the fact that the assets have been deposited in the various states?

3. Or, shall the assets on deposit in any particular state be considered as securing the contract liabilities of *only the contract holders of that state?* And, if so:

(a) Shall the assets be regarded as covering the over-all liability to contract holders in that state, regardless of contract series?

(b) Or, shall the separate assets be regarded as belonging only to the contract holders of the series for which the assets were *deposited?*

(c) Or, shall the separate assets be regarded as belonging only to the contract holders of the series for which the assets were *purchased?*

(d) The Statute of the State of West Virginia requires, as a prerequisite for securing a license to do business, a deposit of $100,000.00 plus additional deposits equal to 100% of the Company's contract liability everywhere (due allowance being made for deposits in other states). How shall the securities deposited with the Treasurer of West Virginia be administered? Will they first be looked upon as securing, in full, the liabilities to West Virginia contract holders? Or, will the West Virginia contract holders share on the same basis

as contract holders in other states? In either event, how will the excess over the liabilities to West Virginia contract holders be administered? This question can be of far reaching importance as, on the basis of present market values, the securities on deposit with the Treasurer of West Virginia exceed by approximately $8,000,000 the liabilities to West Virginia contract holders. What will be the equitable basis in using any part of this excess, for example, to secure claims of contract holders in states where the market value of securities may be only 50%, 35%, 28%, 16% and 10% of the liabilities?

(e) In which state shall the liability to the contract holder be established in a situation like the following: The contract holder purchased the contract in a state which required a deposit of securities equalling 100% of the liability in the state, and at a later date moved either to a state which required a lesser deposit in proportion to liabilities there or to a state requiring no deposit, or a fixed deposit without regard to liabilities.

To summarize this statement your Trustee again refers to the Part One Report which pointed out that the business presents many complex problems, and we have attempted to present some of them. Your Trustee believes that as soon as possible, following the decision of the appeal now pending in the United States Circuit Court of Appeals, a decision should be had on the status of the separate funds and the priorities, if any, of the holders of contracts in each fund. Your Trustee is of the opinion that it can best be done in connection with and as a part of whatever claim procedure is decided upon.

Taking into consideration all facts and circumstances relating to debtor's property and financial conditions,

your Trustee is of the opinion that a reorganization, within the objects of Chapter X, can be worked out which will be of benefit to the contract holders.

Respectfully submitted,

CENTRAL TRUST COMPANY,

Trustee.

April 13, 1942.

**Order of District Court Approving Engagement of John V. Ray as Counsel to Aid Other Counsel of Fidelity**

(At a District Court of the United States for the Southern District of West Virginia, at Charleston, in said District, on August 25, 1942)

| | | |
|---|---|---|
| In the Matter of | ) | No. 4514 |
| FIDELITY ASSURANCE | ) | In Proceedings |
| ASSOCIATION, | ) | for Corporate |
| *Debtor.* | ) | Reorganization |

This day came Fidelity Assurance Association, Debtor, by its attorney James R. Fleming and presented its petition for authorization to engage John V. Ray of Charleston, West Virginia, as additional counsel to aid and assist other counsel for Fidelity Assurance Association, Debtor, in the proceedings for corporate reorganization pending herein; and said petition is ordered filed.

And the prayer of said petition being proper, the same is granted and approved and Fidelity Assurance Association, Debtor, is hereby authorized to engage John V. Ray of Charleston, West Virginia, as counsel to aid and assist other counsel of Fidelity Assurance Association, Debtor, in the proceedings for corporate reorganization filed herein.

This order, having been inadvertently omitted from entry on the 3rd day of September, 1941, is entered now for then, and shall be effective as of September 3rd, 1941.

Enter:

(Signed) Ben Moore
U. S. District Judge.

A true copy from the record,
Attest:

(Signed) Earl R. Cavender, Clerk
(SEAL) D. C. U. S., S. D. W. Va.

**Order of Circuit Court Approving Engagement of Homer A. Holt as Additional Counsel to Aid Other Counsel of Fidelity**

IN THE UNITED STATES CIRCUIT COURT OF APPEALS

FOURTH CIRCUIT

No. 4923

EDGAR B. SIMS, Auditor of the State of West Virginia, and, Ex Officio Insurance Commissioner of the State of West Virginia, et al.,

*Appellants,*

vs.

FIDELITY ASSURANCE ASSOCIATION, a corporation, Debtor,

*Appellee.*

This day came Fidelity Assurance Association, Debtor, by its attorney James R. Fleming and presented its petition for authorization to engage Homer A. Holt of Charleston, West Virginia, as additional counsel to aid and assist other counsel for Fidelity Assurance Association, namely, the said James R. Fleming and John V. Ray, in the preparation and presentation of a petition for rehearing in the United States Circuit Court of Appeals, Fourth Circuit and, in the event said petition be denied, in the preparation and presentation of a petition in the Supreme Court of the United States for a writ of certiorari to the United States Circuit Court of Appeals, Fourth Circuit, and to aid said counsel in the preparation and presentation of the case in the Supreme Court of the United States in the event said petition for certio-

rari be presented and granted; and said petition is hereby ordered filed.

And the prayer of said petition being proper, the same is granted and approved and Fidelity Assurance Association, Debtor, is hereby authorized to engage Homer A. Holt of Charleston, West Virginia, as counsel to aid and assist the other counsel of Fidelity Assurance Association, Debtor, in the preparation and presentation of the petitions as aforesaid and in the preparation and presentation of this case before the Supreme Court of the United States in the event such petition for certiorari to the United States Circuit Court of Appeals, Fourth Circuit, be presented and granted.

This order, not having been presented on the 10th day of July, 1942, and Homer A. Holt having rendered services from that date, it is entered now for then and shall be effective as of July 10, 1942.

(Signed) John J. Parker
Senior Circuit Judge.

Endorsed
"FILED
Aug 15 1942
Claude M. Dean
Clerk"

A true copy
Teste:

(Signed) Claude M. Dean Clerk,
U. S. Circuit Court of
Appeals, Fourth Circuit

(SEAL)

FILE COPY

SEP 24 1942
CHARLES ELMORE CROPLEY
CLERK

No. 319

# In the Supreme Court of the United States

OCTOBER TERM, 1942

FIDELITY ASSURANCE ASSOCIATION AND CENTRAL TRUST COMPANY, PETITIONERS

*v.*

EDGAR B. SIMS ET AL.

*ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT*

## MEMORANDUM FOR THE SECURITIES AND EXCHANGE COMMISSION

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# In the Supreme Court of the United States

OCTOBER TERM, 1942

No. 319

FIDELITY ASSURANCE ASSOCIATION AND CENTRAL TRUST COMPANY, PETITIONERS

*v.*

EDGAR B. SIMS, ET AL.

*ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT*

## MEMORANDUM FOR THE SECURITIES AND EXCHANGE COMMISSION

In the District Court the Securities and Exchange Commission became a party to the present proceeding for the reorganization of Fidelity Assurance Association under Chapter X of the Bankruptcy Act,[1] participated as an appellee before the Circuit Court of Appeals, and is named a respondent by petitioner here.

This memorandum is filed in support of the petition.

[1] The Commission appeared at the court's request pursuant to the provisions of section 208 of the Bankruptcy Act, as added by section 1 of the Act of June 22, 1938, 52 Stat. 894 (U. S. C., title 11, sec. 608).

## OPINIONS BELOW

The opinion of the Circuit Court of Appeals (R. 363–387) is reported in 129 F. (2d) 442. The opinion of the District Court (R. 3–38) is reported in 42 F. Supp. 973.

## JURISDICTION

The judgment of the Circuit Court of Appeals was entered June 16, 1942 (R. 387–388). A petition for rehearing (R. 389–393) was denied July 22, 1942 (R. 397). Jurisdiction of this Court is invoked under section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

## QUESTIONS PRESENTED

1. Whether petitioner association was an "insurance corporation" within the meaning of section 4 of the Bankruptcy Act when it filed a petition for reorganization as a corporate debtor.

2. Whether the court below erred in holding that the petition had not been filed in good faith within the meaning of section 146 (3) and (4) of the Bankruptcy Act.

## STATUTES INVOLVED

Section 4 (a) of the Bankruptcy Act, as amended (U. S. C., title 11, sec. 22 (a)), provides:

> Any person, except a municipal, railroad, insurance, or banking corporation or a building and loan association, shall be entitled to the benefits of this Act as a voluntary bankrupt.

Section 141 of the Bankruptcy Act, as added by section 1 of the Act of June 22, 1938, 52 Stat. 887 (U. S. C., title 11, sec. 541), provides:

> Upon the filing of a petition by a debtor, the judge shall enter an order approving the petition, if satisfied that it complies with the requirements of this chapter and has been filed in good faith, or dismissing it if not so satisfied.

Section 146 of the Bankruptcy Act, as added by section 1 of the Act of June 22, 1938, 52 Stat. 887 (U. S. C., title 11, sec. 546), provides, in part:

> Without limiting the generality of the meaning of the term "good faith", a petition shall be deemed not to be filed in good faith if— * * *
>
> (3) it is unreasonable to expect that a plan of reorganization can be effected; or
>
> (4) a prior proceeding is pending in any court and it appears that the interests of creditors and stockholders would be best subserved in such prior proceeding.

## STATEMENT

Petitioner Fidelity Assurance Association is a West Virginia corporation with its principal place of business in Wheeling, West Virginia (R. 5, 363–364). From November 1912 to the end of 1940, under the name of Fidelity Investment Association, it was engaged exclusively in the business of selling its own securities in the form of investment contracts (recently known as face-amount

certificates) and in investing and reinvesting the proceeds of such sales (R. 5, 364). It sold 6 different series of contracts at various times in 29 states and the District of Columbia (R. 7, 365–366, 368).[2] Some of the contracts carried insurance features, but the insurance risks were carried by an insurance company to which Fidelity paid premiums, and not by Fidelity (R. 6, 19, 368–369, 370). Fidelity contracted to segregate the proceeds of contracts of each series (less expense deductions) for the benefit of contract holders of that series. It kept books showing the status of the several series separately, and particular securities acquired were allocated to the various funds (R. 9).

The State of West Virginia required Fidelity to deposit, as security for its obligations to contract holders, property of a value equal to $100,000 more than the company's net cash liability on all its outstanding contracts, less the amount of similar deposits required by other states. West Virginia Code, c. 33, Art. 9, sec. 3. Fourteen other states require some sort of deposit (R. 7–8, 365). The property thus deposited by Fidelity constitutes about 95 per cent of its assets (R. 366). The state depositaries did not segregate the deposited securi-

[2] There are outstanding contracts in the face amount of $181,948,026.70, representing a net cash liability of $23,475,668.67 owed to approximately 88,000 holders (R. 366). Holders of such contracts now reside in each of the 48 states, the District of Columbia, and foreign countries (R. 366).

ties according to series even where they had notice of the particular series of contracts to which the deposited securities belonged (R. 9). In five states the local statute excludes nonresident contract holders from participating in the local deposit; in other states it is not clear that nonresidents have no interest.[2] The statutes do not expressly indicate whether the measure of claims against the deposits is the amount paid in at the cash surrender value, the reserve value of the contracts, or some other amount.

At least as early as 1940 Fidelity was insolvent. It could not meet the reserve requirements for face-amount certificate companies contained in section 28 of title I of the Investment Company Act of August 22, 1940, 54 Stat. 829 (U. S. C., title 15, sec. 80a–28) (R. 11, 367, 369). On December 31, 1940, the day before that statute was to become effective and its reserve requirements become applicable to Fidelity, it amended its charter so as to obtain insurance powers, at the same time changing its name to Fidelity Assurance Association; this amendment was designed to avoid the requirements of the Investment Company Act, which do not apply to insurance companies (R. 11, 19–20, 340–341, 367, 369). Fidelity received a license to

[2] There is also uncertainty under most statutes on the question of who are residents: whether the deposits secure persons residing in the state at the time of sale of the contracts, persons residing in the state at the time the deposit is made, or persons now residing in the state.

do business as an insurance company from January 1, 1941, to April 1, 1941, upon an understanding with the Auditor of West Virginia (*ex officio* Commissioner of Insurance) that it would engage in no business until he gave it permission to do so (R. 11–12, 369–370).[4] Subsequently, without an authorization from the Auditor, it sent out riders to its series B contract holders assuming direct liability on the insurance provisions of the series B contracts, continuing, however, to pay premiums to the insurance company which had theretofore carried these risks (R. 341–343, 370). It wrote no new investment contracts after December 31, 1940, but it continued to service existing contracts (R. 11–12).

The insurance license expired March 31, 1941. Application for a renewal of the license was made, but no renewal was granted. The Auditor of West Virginia on April 4, 1941, directed Fidelity to discontinue the transaction of all business. On April 11, 1941, the Circuit Court of Kanawha County, West Virginia, appointed receivers for Fidelity on a petition filed by the Auditor with a view to reorganization. (R. 12–13, 249–258, 370.) One of the receivers is a member of the law firm which represented Fidelity, and this firm now acts

[4] Fidelity also agreed to write no more investment contracts, although its license to issue face-amount certificates did not expire until April 1, 1941 (R. 11, 370).

as attorneys for the receivers (R. 32, 139–140, 314).[3] Other receivership proceedings were begun in eleven other states (R. 13, 370–371).

On June 6, 1941, Fidelity filed a voluntary petition under Chapter X of the Bankruptcy Act in the District Court of the United States for the Southern District of West Virginia. The court then appointed a trustee, enjoined the various state receivers and others from disposing of Fidelity's property in their hands, and ordered the receivers to deliver to the trustee the property of Fidelity which they held. The court later ordered state officials holding deposits of Fidelity's property to deliver them to the trustee. The state receivers and depositaries were permitted by the court to intervene and file answers controverting the allegations of Fidelity's position. Extended hearings were held, during which the court rescinded its turn-over order with respect to state depositaries (R. 3–4, 319–334, 371).

At the conclusion of the hearing the District Court approved Fidelity's petition and overruled motions to rescind its standing turn-over and freezing orders (R. 38–40). The Circuit Court of Appeals reversed, holding (1) that Fidelity was

[3] The District Court found that the history of Fidelity has been marked by extravagance and other serious mismanagement (R. 29). A number of its officers and directors are under indictment for violations of the Securities Act of 1933 and the federal mail fraud statute.

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an insurance corporation and therefore not eligible for reorganization under Chapter X of the Bankruptcy Act, and (2) that the petition had not been filed in good faith; rehabilitation of Fidelity not being reasonably possible, continuation of the prior state-court receiverships for liquidation purposes would serve the interest of creditors better than proceedings under Chapter X (R. 363–388).

## ARGUMENT

### I

Fidelity's business before December 31, 1940, was unquestionably that of an investment company selling face-amount certificates, and not that of an insurance corporation. Clearly, if it had then sought Chapter X reorganization it would have been held eligible. The fact that at the end of 1940 it changed its name from Fidelity Investment Association to Fidelity Assurance Association, procured a charter amendment conferring insurance powers, and obtained a license to do insurance business with the understanding that it should do none except with specific permission from the state licensing official should not alter Fidelity's status. Its sole business of substance continued to be investment contracts. Such insurance business as it later purported to transact, without the West Virginia Auditor's authorization, was insubstantial; its assumption of liabil-

ity on the insurance features of some of its contracts was only secondary, so that it incurred no real risks, since Lincoln National Life Insurance Company continued to insure these contracts on a policy maintained by Fidelity.[3]

The Circuit Court of Appeals, however, held that Fidelity's status for purposes of the Bankruptcy Act was to be determined not by its predominant business activity (pursuant to which it had acquired all its assets and incurred all its substantial liabilities) but by its charter powers and classification under state law, although this status on which the court relied was assumed only after Fidelity had gone virtually out of business (see R. 372–373, 376, 379). The court believed that under the laws of West Virginia (and of most of the states in 1910, when Congress inserted the present excepting clause in section 4 of the Bankruptcy Act) Fidelity was an insurance corporation with incidental annuity powers at the time of filing its petition for reorganization. The rule that classification of a company for purposes of state regulation is determinative of its status under the federal Bankruptcy Act was rested by the court on the theory that Congress had excluded "insurance

[3] In its dealings with the Virginia Corporation Commission Fidelity specifically stated that it had issued no insurance policies, pointing out that the riders sent to series B contract holders created no insurance risks (R. 359–360).

corporations" from federal corporate reorganization because companies in such a category were comprehensively regulated during their active existence by state laws and should be similarly administered in case of rehabilitation or dissolution; to determine whether a particular company fell within the class it was necessary to inquire concerning its classification under the applicable state law (see R. 374–378). The soundness of this *rationale* in the present case disappears when it is noted that face-amount certificate companies in West Virginia were subject to regulation similar to and as comprehensive as that applied there to insurance corporations and were subject to identical liquidation procedures (see R. 124–130; Pet. 52–56). Unquestionably, an investment company under state law is eligible for reorganization under Chapter X.

The decision of the Circuit Court of Appeals that Fidelity's charter powers and classification under West Virginia law govern its eligibility for reorganization conflicts with the decision of the Circuit Court of Appeals for the Sixth Circuit In re *Roumanian Workers Educational Ass'n of America*, 108 F. (2d) 782. The view of the Sixth Circuit, that the character of activity actually carried on is the important criterion, is the view taken by legal writers. Finletter, *Law of Bankruptcy; Reorganization* (1939) 107; Note, *Bankruptcy; Corporate Reorganization: Survey of*

*Chapter X in Operation* (1941), 18 N. Y. U. L. Q. Rev. 399, 402.[1]

In addition, the first question presented by this case is one for certiorari because of its importance in the administration of federal statutes. It involves the eligibility for and amenability to corporate reorganization under Chapter X of face-amount certificate and other investment companies which procure incidental insurance powers, making insubstantial use of them. Fidelity alone has in excess of $20,000,000 of assets; other similar companies are also large financial institutions which have attracted the savings of large numbers

[1] The court below referred to cases in other circuits as supporting its rule (see R. 375–379). Those cases contain statements that charter power and state classification constitute the controlling consideration. *E. g.*, In re *Union Guarantee & Mortgage Co.*, 75 F. (2d) 984, 985 (C. C. A. 2); *Woolsey* v. *Security Trust Co.*, 74 F. (2d) 334, 335, 337 (C. C. A. 5); *Security B. & L. Assn.* v. *Spurlock*, 65 F. (2d) 768, 771 (C. C. A. 9); *Kansas* v. *Hayes*, 62 F. (2d) 597, 599–600 (C. C. A. 10); *Clemons* v. *Liberty Savings & Real Estate Corp.*, 61 F. (2d) 448, 450 (C. C. A. 5). It is to be noted, however, that in most of the cases the decisions were equally consistent with the view that business actually done should be the controlling factor. *Woolsey* v. *Security Trust Co.*, *supra*; *Security B. & L. Assn.* v. *Spurlock*, *supra*; *Kansas* v. *Hayes*, *supra*; *Clemons* v. *Liberty Savings & Real Estate Corp.*, *supra*. Charter power and state classification have in fact been determinative in only two situations: (1) where there is the possibility that activities carried on *ultra vires* affect the corporation's amenability to bankruptcy (*Gamble* v. *Daniel*, 39 F. (2d) 447 (C. C. A. 8)), and (2) where the activities carried on do not fall within an easily recognized category (In re *Prudence Co.*, 79 F. (2d) 77 (C. C. A. 2); In re *Union Guarantee & Mortgage Co.*, *supra*). Clearly, neither of those situations exists in Fidelity's case.

of persons throughout the United States for investment.[*] As we endeavor to point out in part II of this memorandum (*infra*, pages 14–16), it is a matter of considerable consequence whether such companies are reorganized in a single federal proceeding or their affairs are settled piecemeal in numerous state proceedings.

The decision below, by pointing out a way in which face-amount certificate companies may avoid bankruptcy, also interferes with the applicability of section 67 (f) of the Bankruptcy Act, as added by section 29 (a) of title I of the Act of August 22, 1940, 54 Stat. 835 (U. S. C., title 11, sec. 107 (f)), providing for the avoidance in certain cases, by the trustee in bankruptcy, of deposits made with state officials by face-amount certificate companies and providing for the distribution in bankruptcy of such deposits. This section is applicable to face-amount certificate companies as defined in section 4 of title I of the Act of August 22, 1940, 54 Stat. 799 (U. S. C., title 15, sec. 80a–4 (1)). Section 3 (c) (3) of title I of the same act excepts insurance companies from the category. 54 Stat. 797 (U. S. C., title 15, sec. 80a–3 (c) (3)). Thus the holding of the Circuit Court of Appeals reaches so far as the coverage of the Investment Company Act of 1940.

[*] It is significant that the Investment Company Act defines an insurance company as one "whose primary and predominant business activity is the writing of insurance or the reinsuring of risks underwritten by insurance companies." Section 2 (a) (17) of title I of the Act of August 22, 1940, 54 Stat. 790 (U. S. C., title 15, sec. 80a–2 (a) (17)).

## II

The court below held also that Fidelity's petition was not filed in good faith within the meaning of section 146 of the Bankruptcy Act. It adverted to the unlikelihood that a plan of reorganization of Fidelity as a going concern could be effected (R. 382–384). If the court's ultimate conclusion that the petition lacked good faith is to be construed as embodying a holding under section 146 (3) of the statute, we think that this Court should grant review of that question. The apparent view of the Circuit Court of Appeals that rehabilitation of the debtor must be in prospect (see R. 383, 384) conflicts with decisions that a plan for slow and orderly liquidation meets the requirements of section 146 (3). In re *Porto Rican American Tobacco Co.*, 112 F. (2d) 655 (C. C. A. 2); *R. L. Witters Associates* v. *Ebsary Gypsum Co.*, 93 F. (2d) 746 (C. C. A. 5); In re *Central Funding Co.*, 75 F. (2d) 256 (C. C. A. 2).

The Circuit Court of Appeals clearly held that the petition lacked good faith because the pending proceedings in various states would best subserve the interests of creditors. The statutes governing those proceedings (see R. 40–57, 203–209; Pet. 52–56) are liquidation and receivership statutes of the type customarily applicable to banks, insurance companies, and other financial corporations. In general the receivers would have jurisdiction

over only the assets in the states of their respective appointment, and would have no power to bring suit to secure assets and surplus deposits in other states. *Booth* v. *Clark*, 17 How. 321, 339; *Great Western Mining Co.* v. *Harris*, 198 U. S. 561; *Lion Bonding Co.* v. *Karatz*, 262 U. S. 77. Nevertheless the court below concluded that continuation of the state proceedings would best subserve the interests of the creditors because (1) it did not clearly appear that there would be any surplus in any state other than West Virginia; (2) the manner of distribution of funds in each state had to be determined in any event according to state law; and (3) creditors could as well file claims for the West Virginia surplus in a West Virginia state court as in the federal court for West Virginia having jurisdiction of these proceedings.

In reaching this conclusion the court below failed to give due weight to circumstances which should be controlling:

(1) There is need in this case for the impartial investigation, into the acts of the management, by an independent trustee (as required by section 167 of the Bankruptcy Act), looking to recoveries for the benefit of creditors. The past history of Fidelity is marked by extravagance and other serious mismanagement. Many of its officers are now under indictment. The general advantages of Chapter X as a reorganization statute have been pointed out by this Court in *Securities and Ex-*

*change Commission* v. *U. S. Realty & Improvement Co.*, 310 U. S. 434. These advantages are particularly clear as against the state procedures in this case, where one of the West Virginia receivers is a member of the law firm which has been counsel to Fidelity, and is a law partner of one of the Fidelity officers under indictment.

(2) The difficult problems of distribution in this case can best be settled in a single administration. Concededly if the respective state deposits were distributed to local creditors there would probably be no surplus in any state other than West Virginia (with the possible exception of Wisconsin, where the assets appear to be worth more than the cash value of the contracts held by Wisconsin residents). But, before there can be any conclusion that no part of the assets in any state is available to contract holders not resident in that state, the following difficult questions must be settled:

(a) It must first be determined whether the state deposits are solely for the benefit of local residents, and not for the benefit of all contract holders. In West Virginia, where clearly nonresidents have an interest in the deposit, it must be determined whether West Virginia creditors have a preferential interest.

(b) It must be determined whether the local deposit is for the benefit of contract holders who resided in the state when their contracts were

sold, who resided there when the deposits were made, or who now reside in the state.

(c) It must be determined whether the measure of claims is the cash value of the contracts, the reserve value, the amount necessary to mature the contracts, the amount paid in, or some other amount.

(d) It must be determined whether states which accepted deposits from Fidelity to secure contracts in a particular Fidelity series, with knowledge that the securities deposited constituted a fund belonging by contract to another series, may keep such assets.

It is obvious that security holders from states without deposits or states with inadequate deposits, must litigate these questions in each of the fifteen states having deposits unless there is to be a central administration in a court of bankruptcy. The facile distributions mentioned in the briefs in opposition filed by respondents (W. Va. Br. 34, 37; Tenn. Br. 16–19) would be effected only by disregarding these questions. We think there should be a central administration even though the questions must be determined according to state law, as remarked by the Circuit Court of Appeals (R. 386).[10]

[10] Federal courts are frequently called upon to determine questions of state law in cases arising because of diversity in citizenship of the parties. *Erie R. Co.* v. *Tompkins*, 304 U. S. 64. The coordinate constitutional jurisdiction of the federal

The question of the weight to be given to factors such as those set out above in determining whether the interests of the creditors will be best subserved by the continuation of prior state proceedings is one of importance. This Court recently granted certiorari in a case presenting similar problems. *Marine Harbor Properties, Inc.*, v. *Manufacturers Trust Co.*, No. 24, October Term, 1942, certiorari granted, 315 U. S. 794.[11] Unlike the situation in the *Marine Harbor* and *Paloma Estates* cases, the property of the debtor here is not all located in a single jurisdiction, but is spread through many.

## CONCLUSION

The Circuit Court of Appeals erred in holding that the petition for reorganization should be dismissed. Its decision conflicts with the decisions of other circuit courts of appeals in holding that petitioner Fidelity Assurance Association was an insurance corporation in 1941 and that the petition was not filed in good faith. The questions presented are important and warrant consideration by this Court. It is therefore respect-

courts in bankruptcy cases should not remain unexercised under a permissive statute merely because questions of state law are raised. The nature of Chapter X and of other Bankruptcy Act proceedings is such that these questions are normally raised.

[11] Another similar case, In re *Paloma Estates, Inc.*, No. 89, October Term, 1942, is pending on petition for writ of certiorari.

fully submitted that the petition for certiorari should be granted.

CHARLES FAHY,
*Solicitor General.*
LEONARD C. MEEKER,
*Attorney.*

JOHN F. DAVIS,
*Solicitor,*
HOMER KRIPKE,
*Assistant Solicitor,*
JUSTIN N. REINHARDT,
*Attorney,*
*Securities and Exchange Commission.*

SEPTEMBER 1942.

U. S. GOVERNMENT PRINTING OFFICE: 1942

FILE COPY

JAN 22 1943

No. 319

# In the Supreme Court of the United States

OCTOBER TERM, 1942

FIDELITY ASSURANCE ASSOCIATION AND CENTRAL TRUST COMPANY, PETITIONERS

*v.*

EDGAR B. SIMS ET AL.

*ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT*

## BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION

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# In the Supreme Court of the United States

OCTOBER TERM, 1942

No. 319

FIDELITY ASSURANCE ASSOCIATION AND CENTRAL TRUST COMPANY, PETITIONERS,

*v.*

EDGAR B. SIMS ET AL.

*ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT*

## BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION

The Securities and Exchange Commission became a party in the District Court to the present proceeding for the reorganization of Fidelity Assurance Association under Chapter X of the Bankruptcy Act,[1] participated as an appellee before the Circuit Court of Appeals, and is named a respondent here. On the points which the court below

[1] The Commission appeared at the court's request pursuant to the provisions of Section 208 of the Bankruptcy Act, as amended by Section 1 of the Act of June 22, 1938, 52 Stat. 894 (11 U. S. C., § 608).

found to be dispositive, the Commission's position here is, in general, aligned with that of petitioners.

This brief is confined to the two issues decided by the court below—whether the debtor is an insurance company and whether its petition under Chapter X was filed in good faith. Respondents in their several briefs in opposition have indicated an intention to urge here a number of other matters collateral to these main issues. Some of these issues (W. Va. Br. in Opp., Addendum, pp. 53–57) raise no substantial questions and were not passed upon by the court below; we shall therefore not treat them in our main brief. Other issues, such as those relating to the legality of the Debtor's meetings and elections (W. Va. Br. in Opp., pp. 20–21; 41–45), largely arise from a conflict among private interests formerly connected with the management involving efforts to control the administration of the company's affairs.[2] Except to the

[2] The Commission did not argue below the questions whether there was valid corporate action authorizing or ratifying the filing of the petition. The Commission did argue below that valid corporate action ratifying the filing of the petition would validate the petition. *Watts* v. *Liberty Royalties Corp.*, 106 F. (2d) 941 (C. C. A. 10); *Massachusetts Construction Co.* v. *Kidd*, 142 Fed. 285 (C. C. Mass., 1905); *Couch* v. *Central Bank and Trust Corp.*, 297 Fed. 216 (C. C. A. 5); *Lawrence* v. *Montgomery Gas Company*, 88 W. Va. 352, 106 S. E. 890 (1921); *Liner* v. *Traders Co.*, 44 W. Va. 175, 28 S. E. 730 (1897); *Porter* v. *Lassen County Land and Cattle Co.*, 127 Cal. 261, 59 Pac. 563 (1899); *Calumet Paper Co.* v. *Haskell Show Printing Co.*, 144 Mo. 331, 45 S. W. 1115 (1898); *Restatement of Agency*, Sections 84, 100.

extent that they may indicate the necessity for Chapter X proceedings, we think it inappropriate for us to argue these questions of internal corporate management.[3]

## OPINIONS BELOW

The opinion of the Circuit Court of Appeals (R. 238–263) is reported in 129 F. (2d) 442. The opinion of the District Court (R. 176–202) is reported in 42 F. Supp. 973.

## JURISDICTION

The judgment of the Circuit Court of Appeals was entered June 16, 1942 (R. 263–264). A petition for rehearing (R. 264–266) was denied July 22, 1942 (R. 267). A petition for a writ of certiorari was filed August 20, 1942 and granted October 12, 1942. Jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

## QUESTIONS PRESENTED

1. Whether petitioner association was an "insurance corporation" within the meaning of Section 4 of the Bankruptcy Act when it filed a petition for reorganization as a corporate debtor.

[3] Those issues do not involve issues of good faith within the meaning of Section 146; in so far as they may be thought to reflect on the debtor's motives in filing a petition under Chapter X, they are immaterial to the statutory tests of Section 146. Cf. *Marine Harbor Properties, Inc.* v. *Manufacturer's Trust Co.*, No. 24, this Term, decided November 9, 1942.

2. Whether the petition was filed in good faith within the meaning of Section 146 (3) and (4) of the Bankruptcy Act.

STATUTES INVOLVED

Section 4 (a) of the Bankruptcy Act, as amended (11 U. S. C. § 22 (a)) provides:

> Any person, except a municipal, railroad, insurance, or banking corporation or a building and loan association, shall be entitled to the benefits of this Act as a voluntary bankrupt.

Section 141 of the Bankruptcy Act, as amended (11 U. S. C. § 541) provides:

> Upon the filing of a petition by a debtor, the judge shall enter an order approving the petition, if satisfied that it complies with the requirements of this chapter and has been filed in good faith, or dismissing it if not so satisfied.

Section 146 of the Bankruptcy Act, as amended (11 U. S. C. § 546), provides, in part:

> Without limiting the generality of the meaning of the term "good faith", a petition shall be deemed not to be filed in good faith if——
>
> * * * * *
>
> (3) it is unreasonable to expect that a plan of reorganization can be effected; or
>
> (4) a prior proceeding is pending in any court and it appears that the interests of creditors and stockholders would be best subserved in such prior proceeding.

The relevant state statutes governing deposit requirements and receivership or liquidation proceedings are set out in Appendix D, Appendices, pp. 10–74.

## STATEMENT

The facts as found by the District Court in its opinion and as shown by the evidence may be summarized as follows (other facts bearing on the issues whether petitioner is an insurance company and the relative advantages of state and Chapter X proceedings are set out in the Argument, *infra*).

1. *The Debtor's Business, History, and Financial Condition.*

Fidelity Assurance Association, the petitioner, is a West Virginia corporation with its principal place of business in Wheeling, West Virginia (R. 4, 612). From November 1912 to the end of 1940, under the name Fidelity Investment Association, it was engaged exclusively in the business of selling its own securities in the form of investment contracts (called "annuity contracts" under the West Virginia statute, and recently known as face-amount certificates) and in investing and reinvesting the proceeds of such sales (R. 177–178, 240).

At various times, Fidelity sold six different series of contracts in 29 states and the District of Columbia (R. 304–316, 479).

There are outstanding contracts in the face amount of $181,948,026.70, representing a net cash

liability of $23,475,668.67 owed to approximately 88,000 holders (R. 242; Ex. 48). Holders of such contracts now reside in each of the 48 states, the District of Columbia, and foreign countries (R. 242; Ex. 48).

The several series of contracts differ only in detail. In general each series provides that the contract holder is to pay a fixed sum monthly for a named period, *e. g.*, ten years, in return for which Fidelity is obligated to pay a fixed sum on a named date (three to thirteen months after the contract holder's last payment), or at the option of the contract holder, to pay the principal sum in ten annual installments (R. 178; Ex. 1–5). Each series of contracts embodies loan and cash surrender provisions under which monthly payments must be made by the purchaser for a period of at least nine months before the contract has any cash surrender value and, depending upon the contract series, for a period of six and a half to nine years before that value is as much as the amount paid in, without interest (R. 178; Ex. 1–5). The monthly payments, after fees and charges are deducted, are required by the contracts to be set aside in reserve funds, which the later contracts required to be segregated by contract series, to assure that Fidelity will be able to discharge its liabilities under the contracts at maturity (Ex. 4, 5).[4]

[4] The terms of the contracts and the manner in which the company conducted its business are described in detail in the Report of the Securities and Exchange Commission on *Com-*

In addition, the Series B contract which Fidelity sold from 1935 to 1940 permits the contract holder to avail himself of a blanket insurance policy issued by Lincoln National Life Insurance Co., an Indiana corporation which has no connection with Fidelity (R. 416, 783; Ex. 4). The premium for this insurance is deducted by Fidelity from the contract holder's periodic payments and is remitted by Fidelity to the insurance company (R. 783–784). If an insured contract holder dies before completing his payments, the insurance company pays Fidelity the discounted value of the remaining payments so that the certificate will mature as originally issued (R. 681–682; 783–784). At least until the 1941 events described below (pp. 12–13), Fidelity assumed no insurance liability under this form of contract or otherwise (Ex. 4; R. 377–378).

In accordance with its undertaking, embodied in its contracts, to segregate the assets by contract series, Fidelity kept books which show the status of the several series separately, and which further show the particular securities allocated to the various funds reserved for the respective contract series (R. 180, 331–332; 342–344; 367–368, 379–381, 581; Ex. 25). In keeping with this theory of segregation, securities were "sold" and moneys

*panies Issuing Face Amount Installment Certificates*, submitted to Congress March 13, 1940, pursuant to Section 30 of the Public Utility Holding Company Act of 1935 (H. Doc. 659, 76th Cong.). See especially pages 200–204, 222–224. This report is in evidence in this proceeding (Ex. 6, 12) and copies have been filed with the Clerk of this Court.

were "borrowed" on open book account between the separate series funds (R. 333, 409, 658–660). Since securities were carried on the company's books at cost, interfund "sales" above cost increased the book value of the company's portfolio and created paper profits which the stockholders shared with the contract holders (R. 658). Interfund "loans" made the total corporate cash freely available in making payments to contract holders of any series, so that the corporation could avoid liquidation of that series' securities, resultant realization of losses, reduction in the book value of the portfolio, and decrease or elimination of income available for stockholders (R. 381–382). The funds which have interfund accounts payable appear to be insolvent, and the solvency of other funds depends on the extent to which their interfund accounts receivable are collectible assets (R. 492–493; Ex. 26, 82).

The domiciliary State of West Virginia required Fidelity to deposit as security for its obligations to all contract holders, wherever located, property of a value equal to $100,000 more than the company's net cash liability on all its outstanding contracts, less the amount of similar deposits required by other states. West Virginia Code, c. 33, art. 9, sec. 3, (Appendix D, Appendices, pp. 63–65). Of the 28 states other than West Virginia in which the company sold its contracts, only 14 required a deposit, the nature and amount of which varied from

state to state.[5] The property thus deposited by Fidelity constitutes about 95 percent of its assets (R. 242; Ex. 25).

Beginning with the Series B and D contracts in 1934, when Fidelity deposited property in the states which required such deposits, it made efforts to maintain segregation by series (R. 601–612, 644, 660; Ex. 60, 61, 72, 73). But some of the state depositaries refused to segregate the securities deposited with them with respect to the particular funds of Fidelity to which the securities belonged (R. 592–593, 633–636; Ex. 60, 62). The state depositaries were aware that Fidelity was contractually obligated to segregate the Series B and D funds, and that in many instances they were holding securities to secure contractual liabilities relating to series other than those to which the securities belonged (R. 654–655, 609, 628, 760–761, 768; Ex. 72–79).

Appendix A, Appendices, pp. 1–2, shows the market value of securities deposited in the various states segregated by series as compared with the net cash surrender liabilities in those states broken down by series.[6]

---

[5] The states which required deposits are Alabama, Delaware, Illinois, Iowa, Indiana, Kansas, Kentucky, Maryland, Missouri, Ohio, Pennsylvania, Tennessee, Virginia, and Wisconsin (R. 241, 347–373). Their statutory requirements relating to deposits are set out in Appendix D, Appendices, pp. 10–74.

[6] Appendix A was compiled from the Chapter X trustee's report filed pursuant to Section 167 of the Bankruptcy Act, filed October 10, 1941 (not printed).

2. *Events Which Led to the Filing of the Petition Under Chapter X.*

Except for a brief period in 1937, Fidelity has been insolvent continuously at least since 1933 (R. 440–443). Its assets have been dissipated by advances to salesmen, margin trading in speculative securities, disastrous investments, and extravagant non-income-producing expenditures (R. 440–476). A suit by the Securities and Exchange Commission in 1938 to enjoin violation of the fraud provisions of the Securities Act of 1933,[7] and a stockholder's suit in 1939 for a receiver and other relief,[8] also marked Fidelity's recent history and had an important impact on its business.

Fidelity made efforts to solve its financial difficulties by reorganization and procurement of new capital almost continuously from 1932 (R. 1136–43).[9] The enactment of the Investment Com-

[7] For the complaint, affidavits, and decree in this case see Report, *supra*, note 4, at 197–245, 257–258.

[8] See *McCammon* v. *Fidelity Investment Assn.*, 26 F. Supp. 117 (N. D. W. Va.), affirmed, *Hutchinson* v. *Fidelity Investment Assn.*, 106 F. (2d) 431 (C. C. A. 4).

[9] From 1936 "on back to the early thirties" the directors, the executive committee, and the finance committee did "talk about trying to get new capital and how we might recapitalize and whatnot" (R. 1136). From 1938 through 1940 (R. 1136–7) Arthur Koontz, a director and member of the finance committee (R. 1167) personally endeavored to reorganize, or procure new capital for, the company from investment banking and commercial banking sources, insurance companies, investment trusts, and finance companies (R. 1136–43). Finally, in 1940, Allen G. Messick and Ber-

pany Act on August 22, 1940, 54 Stat. 789 (15 U. S. C. § 80a (1)–(52)), however, seriously complicated these reorganization efforts. Fidelity was subject to the Act, which, as a condition precedent to the sale of new contracts, required the maintenance of specified reserves and imposed expense loading limitations (Sec. 28). Fidelity's financial condition precluded its satisfying these reserve requirements and its scale of expenses exceeded the income it could expect under the expense loading limitations (R. 404, 630, 669, 796–797, 864–877). But if it could not sell new contracts, it could

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nard Rosset, of Chicago, entered into a contract to invest $500,000 in a new company which would assume certain of Fidelity's contract liabilities (R. 1142–4). This contract was never performed and Koontz's efforts to secure new capital for the company ceased when Messick became chairman of the board in 1940. Messick continued the efforts to secure new capital. (R. 1144.)

In December 1940, Koontz resumed his efforts to reorganize the company (R. 1144–5). He did some work "with a view of preparing the company to go into the business of life insurance if the [company's financial] statement, in the Auditor's judgment, showed that it should be permitted to write life insurance" (R. 1146, 1157) "but they were never able to get the green light from the Commissioner" (R. 1146). During this period the company "was not doing business—it was not permitted to do business, and Mr. Sims [Auditor and *ex officio* Insurance Commissioner of West Virginia, see *infra*, p. 12] had stated to them that he wasn't going to permit them to do business unless there was a change in the situation" (R. 1156). Thus, the beginning of 1941 was characterized by continuous efforts to work out a voluntary recapitalization plan (R. 1147–9) to forestall involuntary proceedings (R. 1150, 1184–6).

become a liquidating enterprise. Consequently, in an attempt to gain time to devise a permanent solution for Fidelity's difficulties, its board of directors adopted the expedient of amending its charter on December 31, 1940, to change its name to "Fidelity Assurance Association" and to enlarge its objects and purposes by the addition of life insurance powers (R. 541; Ex. 20). Fidelity did not, however, abandon its existing charter power to continue the annuity contract business in which theretofore it had been exclusively engaged. Instead, in order to be able to continue receiving payments on contracts previously sold and to make payments on contracts which matured or were surrendered for cash (R. 669), Fidelity filed with the Securities and Exchange Commission the notification of registration as an investment company required by Section 8a of the Investment Company Act (R. 667).[10]

After Fidelity amended its charter, the respondent Edgar B. Sims, Auditor and *ex officio* Insurance Commissioner of West Virginia, issued a license to Fidelity to do business as an insurance company from January 1, 1941, to March 31, 1941, upon the express condition that it would engage in no business except the servicing of its outstanding face amount certificates until he gave it permission to do so (R. 406, 438, 701; Ex. 24). In

[10] No other form of registration with the Commission has yet been required of face amount certificate companies.

spite of this condition, Fidelity transmitted to its Series B contract holders riders which when signed by them purported to make Fidelity an insurer (R. 237–238; Appendix B). Upon expiration of its insurance license on March 31, 1941, Fidelity applied for a renewal which was executed but never delivered (R. 237).[11] On April 4, 1941, Sims directed Fidelity to discontinue the transaction of all business (R. 246, 702). On April 11, 1941, the Circuit Court of Kanawha County, West Virginia, appointed receivers for Fidelity on a petition filed by Sims (R. 246; Ex. 21). Shortly thereafter independent actions were begun in eleven other states (R. 246–247). Most of these were liquidation proceedings begun by state officials in the state courts, some were equity proceedings in state or federal courts, and some were purely administrative. The statutory provisions under which these proceedings were instituted in the various states are set out in Appendix D, Appendices, pp. 10–74. None of the state proceedings made substantial progress toward the collection of assets and determination of claims, except in Wisconsin where approximately half of the local de-

[11] Fidelity's investment company license also expired on March 31, 1941. On March 8, 1941, the statute providing for such licenses (West Virginia Code, c. 33, art. 9, sec. 1) was repealed and replaced by a statute which is integrated with the Investment Company Act of 1940 (W. Va. L. 1941, c. 46, March 8, 1941). Fidelity never qualified under the new West Virginia statute.

posit was liquidated and proofs of claim were received."[12]

3. *The Chapter X Proceeding.*

On June 6, 1941, Fidelity filed a voluntary petition under Chapter X of the Bankruptcy Act in the District Court of the United States for the Southern District of West Virginia (R. 4). The court appointed a trustee, enjoined the various local receivers and others from disposing of Fidelity's property in their hands, and ordered the local receivers to deliver to the trustee the Fidelity property which they held (R. 1). The court later ordered state officials holding deposits of Fidelity's property to deliver them to the trustee (R. 11). The local receivers and depositaries and various creditors were permitted by the court to intervene and file answers controverting the allegations of Fidelity's petition (R. 15–20, 29, 31, 48, 58, 79, 88–96, 118–161). Extended hearings were held on the question of approval of the petition. In the course of these hearings, the district court rescinded its order on state depositaries to turn the deposits over to the trustee, but left the turn-over order in effect as to the local receivers (R. 102–114).

On January 5, 1942, the District Court approved the petition and overruled motions to rescind its standing turn-over and freezing orders (R. 175).

[12] After the decision of the court below certain of the states called for the filing of proofs of claim, pursuant to that court's order on the stay of its mandate (R. 268–270).

The Circuit Court of Appeals reversed (R. 263) on two separate grounds: (1) that Fidelity was an insurance corporation and therefore not eligible for reorganization under Chapter X of the Bankruptcy Act; and (2) that the petition had not been filed in good faith, since rehabilitation of Fidelity was not reasonably possible and therefore continuation of the prior pending proceedings for liquidation purposes would better serve the interest of creditors than proceedings under Chapter X (R. 238–263).[13]

## SPECIFICATION OF ERRORS

The court below erred:

1. In holding that petitioner Fidelity Assurance Association is an "insurance corporation" within the meaning of Section 4 of the Bankruptcy Act, and so is ineligible to receive the benefits of the Act as a voluntary bankrupt.

2. In holding that the petition was not filed in good faith.

## SUMMARY OF ARGUMENT

### I

Since the facts establish that Fidelity is not an insurance corporation, it is not disqualified under Section 4 (a) of the Bankruptcy Act from the benefits of that Act as a voluntary bankrupt. For 28

[13] The court below did not pass upon the other objections to the Chapter X proceedings raised by respondents and others.

years and until December 1940, Fidelity was licensed only to sell annuity contracts under a provision expressly inapplicable to insurance corporations; it was, therefore, not authorized to do an insurance business and it did not engage in such business.

The amendment of its charter in December 1940 to include insurance powers, and its issuance of riders purporting to assume liability under the insurance provisions of its Series B contracts, were insufficient to make Fidelity ineligible under Section 4 (a). All of the $23,000,000 liabilities of Fidelity were incurred in its sale of investment contracts prior to its charter amendment. The enlarged license to do insurance business was merely an artificial device to achieve other purposes and it was expressly ineffective. Nor, in fact, did the issuance of the riders result in any insurance liability since the actual consequence was only the continuance of an arrangement under which an insurance company unconnected with Fidelity insured the contract payments on a group basis.

Even if the issuance of riders may be considered to be the doing of insurance business contrary to its actual licensed powers, the controlling test is the nature of the principal pursuit of the company; the touchstone is what the company actually does, not what it is empowered to do. Plainly here Fidelity's insurance business, if any, was of negligible significance for purposes of determining its eligibility under Section 4 (a).

II

A. Whether Fidelity can be reorganized on a going concern basis or whether only some form of liquidation is in order for it, there is no lack of good faith within the meaning of Section 146 (4). That the interests of the creditors will not be subserved better by the various state receivership and liquidation proceedings than in a Chapter X proceeding appears from three separate factors establishing the desirability of a central administration which provides a machinery for effective marshalling of assets and equitable and precise distribution to creditors who are legally entitled to such assets.

1. The facts relating to Fidelity's course of business and its reorganization efforts show that there is a necessity for the impartial and expert investigation which Chapter X affords. The record indicates that extravagance and mismanagement mark Fidelity's business. Fidelity and its officers and directors have been enjoined from violations of the fraud provisions of the Securities Act. Whatever the actual facts may ultimately be disclosed to be, investigation of possible civil actions on behalf of Fidelity's estate is appropriate. Yet the state proceedings give no promise of vigorous investigation comparable to that which may fairly be expected in Chapter X proceedings. Thus, in states other than West Virginia, there are obstacles of venue and jurisdiction, while in respect of the West Virginia proceedings, the record establishes interlock-

ing relationships among the receivers, their counsel, and Fidelity's officials, which would at the least indicate divided loyalities standing in the way of thorough exploration of the facts.

2. The task of marshalling assets and of distribution presents a number of difficult issues which can best be settled in a single administration under Chapter X, rather than by separate administration in a dozen state proceedings. In order to assure that there be distribution of the assets in the proper amounts to legally entitled creditors, the assets of the various series of contracts must be disentangled, and distribution must depend upon the determination of complex issues presenting questions both of identity of the creditors and of amount due. The state officials, however, propose immediate distribution without awaiting litigation of such issues. Unless there is a single forum which is available for the presentation of all these issues, the contract holders will be likely, as a practical matter, to be deprived altogether of the opportunity to litigate their claims, for there are many classes of contract holders scattered throughout the country, with claims on the basis of net cash liability, averaging only $273.

3. A single administration under Chapter X furnishes a superior vehicle for liquidation of Fidelity's assets. Fidelity's portfolio is such as to require skillful and orderly disposition for fullest realization upon the securities. The several state

proceedings are not such as to afford appropriate machinery for such a task.

B. There is no lack of good faith within the meaning of Section 146 (3). Even assuming that Fidelity could not be rehabilitated as a going concern, there are other methods of disposition of the assets which appear to be appropriate here and which satisfy the requirement of Section 146 (3) that it be not unreasonable to expect that a "plan of reorganization" can be effected. For example, the creation of a new corporation or other device to liquidate assets (which respondents now insist is the only feasible course) is a "plan of reorganization" under the Act. Accordingly, it cannot be said that it is unreasonable to expect that a plan of reorganization may be effected.

## ARGUMENT

### I

### FIDELITY IS NOT AN INSURANCE CORPORATION AND CAN BE A BANKRUPT

Section 4 (a) of the Bankruptcy Act (*supra*, p. 4) withholds the benefits of that Act from "insurance corporations." We submit that this exclusion is inapplicable here since Fidelity was not an insurance corporation within the meaning of that section.

The facts relating to this issue are undisputed. They establish that Fidelity cannot be regarded as ineligible for the benefits of the Bankruptcy Act.

For 28 years, until December 1940, Fidelity was licensed only for the purpose of selling the "annuity contracts" described at pp. 6–7, *supra* (Ex. 20). It is clear that the sale of these contracts did not constitute doing an insurance business. It sold these contracts pursuant to its license as an investment company under West Virginia Code, c. 33, art. 9, sec. 1, which was expressly inapplicable to insurance companies.[14] Fidelity, therefore, was not authorized to engage in the insurance business during this period; and it did not so engage (R. 377–378, 416).

The events of December 1940 and thereafter did not transform Fidelity into an insurance corporation. Recognizing that it was unable to qualify under the Investment Company Act of 1940[15] for the sale of new investment contracts, and in order to avoid the requirements of that Act, which are

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[14] C. 33, art. 9, sec. 1, provided in pertinent part:

> No person, association or corporation shall engage in the business of soliciting or receiving deposits or payments on any annuity contract or certificate or annuity bond in fixed and stipulated installments, within this State, without first having obtained from the insurance commissioner a license to do business in this State: *Provided, however*, That this article shall not be construed as applying to * * * insurance companies, foreign or domestic, duly authorized to do business in this State * * *.

This section was repealed by W. Va. L. 1941, c. 46, March 8, 1941.

[15] 15 U. S. C., § 80a (1)–(52). The Act became effective on January 1, 1941.

inapplicable to insurance companies (sec. 3 (b) (3)), Fidelity resorted to the device of amending its charter, as of December 31, 1940, so that it would have power "To issue insurance on the lives of persons and every insurance appertaining thereto and connected therewith, and to grant, purchase and dispose of annuities." (R. 541; Ex. 20.) The added power which it thus procured was not of practical significance. It not only retained its power to deal in annuities, but in fact that continued to be the full extent of the exercise of its charter powers. While after December 31, 1940, Fidelity sold no new annuity contracts (being precluded from doing so under the Investment Company Act of 1940), it continued to make payments on contracts which matured or were surrendered for cash and to service outstanding contracts and collect payments thereon (R. 406), and registered with this Commission under the Investment Company Act for these purposes (R. 667). On the other hand, despite the charter amendment, Fidelity at no time was permitted to engage in insurance business, for its license to engage in such business for the period ending March 31, 1941, was granted by the West Virginia Auditor on the express condition that it would engage in no new business of any kind (R. 227, 406, 438, 701). On March 31, 1941, Fidelity's license to do an investment business and its license to do an insurance business expired together, and renewal was refused (R. 246, 237). By April 4,

1941, its corporate functions of all kinds were suspended (R. 702).

It is apparent, therefore, that when the West Virginia receivership and the instant proceedings were instituted, Fidelity was not licensed to engage in any business whatever, and the only substantial business in which it had ever engaged or for which it had ever been effectively licensed was that of selling annuity investment contracts. And, significantly, all of Fidelity's liabilities of over $23,000,000—the discharge of which is the concern of the Bankruptcy Act—were incurred in doing the business of selling its investment contracts before Fidelity's charter contained any insurance powers.

The conclusion that Fidelity did not function as an insurance company is not affected by the fact that on December 31, 1940, it sent to the holders of its Series B contracts riders which purported to assume liability under the insurance provisions of those contracts (R. 237; see *supra*, p. 13).[16] The Series B contract holders signed and returned 9,802 of these riders to Fidelity. This circumstance, however, is insufficient to warrant treating Fidelity as an insurance company. If this be an insurance transaction,[17] it was in direct violation of

[16] The riders and accompanying letter appear in Appendix B, Appendices, pp. 3–5.

[17] In its dealings with the Virginia Corporation Commission and the Banking Commission of Wisconsin Fidelity specifically stated that it had issued no insurance policies, pointing out that the riders sent to Series B contract holders created no insurance risks (R. 223–226).

Fidelity's agreement with the West Virginia insurance commissioner that it would write no insurance under its insurance charter and license (*supra*, p. 21). But in any event, it is plain that the transaction was lacking in important elements characteristic of the usual insurance business. As the court below recognized (R. 246), Fidelity continued to transmit the contract holders' premium payments to the Lincoln National Life Insurance Company, which had issued the group insurance policy protecting the Series B contract holders (R. 783 ff). In addition, the issuance of these riders resulted in no insurance liability which Fidelity is being called upon to discharge, since Lincoln National is able to respond on the contract. And, it is to be noted, the court below in reviewing Fidelity's liabilities (R. 241–245) did not refer to insurance liabilities at all. Especially as it relates to the instant question, therefore, the issuance of the riders wrought no significant change from the situation which had originally obtained in respect of the insurance features of the Series B contracts, for Fidelity incurred no real risks and Lincoln National continued to be liable on these contracts under the group insurance policy.

We submit that in these circumstances Fidelity's illegal gratuitous assumption of a liability without risk on outstanding insurance cannot be regarded as having put it into the insurance business.[18]

[18] Essentially, the change in debtor's charter and subsequent developments were but steps in an attempted extra-

Even assuming that Fidelity's activities after January 1, 1941, constituted the doing of an insurance business, no liability or liquidation problems were created, and the business remained that of an investment company, which has been carried on for nearly 30 years. "Where a corporation is engaged in two or more distinctive lines of business, one of which would subject it to the Bankruptcy Law, while the other would not, the decision of its amenability to the involuntary Bankruptcy Act will depend on the nature and character of that business which, under all the facts and circumstances, constitutes its chief or principal pursuit. *Cate* v. *Connell*, * * * 173 F. 445 * * * *In re Interstate Paving Co.* (D. C.) 171 F. 604." *In re Wisconsin Co-operative Milk Pool*, 35 F. Supp. 787, 789–90 (E. D. Wis.). See also *In re Dairy Marketing Association of Ft. Wayne, Inc.*, 8 F. (2d) 626 (D. Ind.). The principle would seem to apply equally to voluntary bankruptcy.

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judicial reorganization of the debtor corporation which had been in progress for some years, *supra*, pp. 10–12. Hence the classification of the debtor's business should be determined by the nature of the business before the changes. Cf. *Capital Endowment Co.* v. *Kroeger*, 86 F. (2d) 976 (C. C. A. 6). The fact that it ceased to sell its investment contracts before the institution of these proceedings is immaterial. *In re Peoria Life Insurance Company*, 75 F. (2d) 777 (C. C. A. 7); *In re National Surety Co.*, 7 F. Supp. 959 (N. D. N. Y.); *In re Union Guarantee & Mortgage Co.*, 75 F. (2d) 984 (C. C. A. 2); *In re New York Title and Mortgage Company*, 9 F. Supp. 319 (N. D. N. Y.).

The court below, however, held (R. 248) that in any event Fidelity's status for purposes of the Bankruptcy Act was to be determined not by its predominant business activity (pursuant to which it had acquired all its assets and incurred all its substantial liabilities), but by its charter powers and its classification under state law. Accordingly, despite the fact, as we have noted, that Fidelity's status as an insurance company was purely formal, that it was acquired only after Fidelity had virtually gone out of business, and that there was no significant exercise of insurance powers, the court below held that Fidelity was ineligible for bankruptcy under Section 4 of the Bankruptcy Act.[19]

[19] This decision may have consequences going beyond the exclusion of this particular corporation from the Bankruptcy Act. Section 28 of the Investment Company Act was expressly enacted to regulate Fidelity and one or two similar face amount certificate companies, in reliance on the report of the Commission dealing with such companies by name (*supra*, note 4). See S. Rep. No. 1775, 76th Cong., 3d Sess., pp. 6, 10–11, 19–20; Hearings before a subcommittee of the Senate Committee on Banking and Currency, 76th Cong., 3d Sess., on S. 3580, Part 1, pp. 301–2, 134. A face amount certificate company is defined in Section 4 (1) of the Act as "an investment company which is engaged or proposes to engage in the business of issuing face-amount certificates of installment type, or which has been engaged in such business and has any such certificate outstanding." An insurance company is defined in Section 2 (a) (17) of the same Act as "a company which is organized as an insurance company, whose primary and predominant business activity is the writing of insurance * * * and which is

We submit that this conclusion overlooks the underlying basis of the exclusions of Section 4. In that section, Congress excluded from the Bankruptcy Act as voluntary bankrupts municipal, railroad, insurance, and banking corporations, and building and loan associations. The essential feature common to these categories of enterprises was recognized by Congress to rest in their "responsibilities to the public" flowing from their performance of a public service. See H. Rep. No. 511, 61st Cong., 2d sess. (1910), p. 5.

If, as we submit, the touchstone is the public interest in maintaining these enterprises as going public services, eligibility for the benefits of the Act as a voluntary bankrupt under Section 4 should rest not upon accidental or formal classification of the debtor but upon the actual nature of its activities. *In re Columbia Ry., Gas & Electric Co.*, 24 F.

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subject to supervision by the insurance commissioner * * * of a State * * *." Under Section 3 (b) (3) of that Act no insurance company is an investment company. Thus the decision of the court below that Fidelity is an insurance company, to the extent that it is influential on the construction of these provisions of the Investment Company Act of 1940, might leave Fidelity immune both from the Bankruptcy Act and from regulation under the Investment Company Act.

Moreover, Section 29 (a) of the Investment Company Act amends Section 67 of the Bankruptcy Act by adding provisions applicable to the bankruptcy of face amount certificate companies. The effect of the decision below is to leave Section 29 (a) with no sphere of operation as applied to face amount certificate companies which choose to resort to the devices adopted by Fidelity.

(2d) 828 (E. D. S. C.), affirmed, 27 F. (2d) 52 (C. C. A. 4). That the debtor may have acquired an insurance charter under state law cannot be controlling unless the powers so granted were exercised to such an extent that the public interest requires their continuance. The character of the activity carried on is the basic criterion; whether a corporation "can be adjudged a bankrupt depends upon what it actually does, not what it is empowered to do." *In re Kingston Realty Co.*, 160 Fed. 445, 446 (C. C. A. 2); *In re Roumanian Workers Educational Association*, 108 F. (2d) 782 (C. C. A. 6); cf. *In re Wisconsin Co-operative Milk Pool*, 119 F. (2d) 999 (C. C. A. 7); *Cate* v. *Connell*, 173 Fed. 445 (C. C. A. 1).[20] And plainly, under this test,

[20] See also *In re Supreme Lodge of the Masons Annuity*, 286 Fed. 180, 184 (N. D. Ga.); *In re Dairy Marketing Association of Ft. Wayne, Inc.*, 8 F. (2d) 626 (D. Ind.). Commentators similarly take the view that the essential test is the character of the corporation's activity. Finletter, *Law of Bankruptcy Reorganization* (1939) 107; Note (1941) 18 N. Y. U. L. Q. 399, 402.

The court below, however, referred to other cases as supporting its rule of state classification (see R. 249–253). These cases contain statements that charter power and state classification constitute the controlling consideration. E. g., *In re Union Guarantee & Mortgage Co.*, 75 F. (2d) 984, 985 (C. C. A. 2); *Woolsey* v. *Security Trust Co.*, 74 F. (2d) 334, 335, 337 (C. C. A. 5); *Security B. & L. Assn.* v. *Spurlock*, 65 F. (2d) 768, 771 (C. C. A. 9); *Kansas* v. *Hayes*, 62 F. (2d) 597, 599–600 (C. C. A. 10); *Clemons* v. *Liberty Savings & Real Estate Corp.*, 61 F. (2d) 448, 450 (C. C. A. 5). It is to be noted, however, that in most of the cases the decisions were equally consistent with the view that business actually done should be the controlling factor. *Woolsey* v. *Security*

Fidelity was not an insurance company ineligible to become a voluntary bankrupt.

## II

### THE PETITION WAS FILED IN GOOD FAITH

As a separate ground of its decision, the court below held that Fidelity did not file its petition for reorganization under Chapter X in good faith (R. 257–263). While the court concluded that "there appears to be no reasonable hope of a reorganization of the business as a going concern, but only the immediate need of a liquidation of the company's assets for the benefit of the contract holders" (R. 259), we do not understand that this was a holding that it is unreasonable to expect that a plan can be effected so that good faith is lacking within the meaning of Section 146 (3) of the Bankrutcy Act (*supra*, p. 4). Rather, the court below appears to have held only that for the purposes

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*Trust Co., supra; Security B. & L. Assn.* v. *Spurlock, supra; Kansas* v. *Hayes, supra; Clemons* v. *Liberty Savings & Real Estate Corp., supra.* Charter power and state classification have in fact been determinative in only two situations: (1) where *ultra vires* acts are relied on as affecting amenability to bankruptcy, *Clemons* v. *Liberty Savings & Real Estate Corp.*, 61 F. (2d) 448 (C. C. A. 5); *Gamble* v. *Daniel*, 39 F. (2d) 447 (C. C. A. 8); *In re H. J. Quimby Freight Forwarding Co.*, 121 Fed. 139 (D. Mass.); (2) where it is debatable whether the business carried on falls within any of the categories excluded by the Act, compare *In re Union Guarantee & Mortgage Co.*, 75 F. (2d) 984 (C. C. A. 2), with *In re Prudence Co.*, 79 F. (2d) 77 (C. C. A. 2); and see *In re Grand Lodge A. O. U. W.*, 232 Fed. 199 (N. D. Calif.).

of Section 146 (4) the respective merits of pending state procedures and the bankruptcy procedure must be tested in the light of the fact that liquidation, not reorganization as a going concern, was the realistic probability. Nevertheless, since the question of good faith under Section 146 (3) was argued below, we shall examine that question as well as the issue of good faith arising under Section 146 (4) in the course of the following argument. We submit that whether Fidelity is to be reorganized or whether it is to be liquidated, the creditors' interests will not be best subserved by the state proceedings and that Chapter X affords a more adequate machinery.

A. *The interests of Fidelity's creditors will not be best subserved by the pending local proceedings*

The court below held that the pending proceedings in various states are superior to the proceedings available under Chapter X for purposes of liquidation, and that, therefore, the instant petition lacked good faith since the local proceedings would best subserve the interests of Fidelity's creditors. None of the statutes governing those proceedings (see Appendix D, Appendices, pp. 10–74) appears to vest title in state liquidators as statutory successors, and, in general, the state receivers would have jurisdiction over only the assets in the states of their respective appointment, and would have no power to bring suit to secure assets and surplus

deposits in other states (R. 1206). *Booth* v. *Clark*, 17 How. 321, 339; *Great Western Mining Co.* v. *Harris*, 198 U. S. 561; *Lion Bonding Co.* v. *Karatz*, 262 U. S. 77. Cf. *Clark* v. *Williard*, 292 U. S. 112. Nevertheless, the court below concluded that continuation of the state proceedings would best subserve the interests of the creditors because (1) it did not clearly appear that there would be any surplus in any state except West Virginia; (2) the manner of distribution of funds in each state must be determined in any event according to the state law; and (3) creditors could as well file claims for the West Virginia surplus in a West Virginia state court as in the federal court for West Virginia having jurisdiction of the instant proceedings.

The issue upon this branch of the case is, ultimately, whether there should be separate liquidations and distributions by the several local receivers, or whether there should be a centralized administration which offers a forum for scrutiny of the history and management of this enterprise and for the resolution of the complex problems involved, and provides a machinery for a more effective and precise distribution. In reaching its conclusion that the local proceedings best subserve the interests of Fidelity's creditors, the court below failed to give due weight to a number of factors which establish the superiority of Chapter X proceedings, which should be controlling, and which led the District Court to sustain the Debtor's petition (R. 194–199).

1. *The necessity for impartial investigation.*—The history of Fidelity and the course of its efforts to reorganize establish that it is peculiarly salutary in this case to utilize the provisions of Chapter X, which makes administrative assistance available to the court (Sec. 208 of the Bankruptcy Act, 11 U. S. C. § 608) and which provides for impartial investigation into the acts of the management by an independent trustee with independent counsel looking to recoveries for the benefit of the estate, and ultimately of the creditors. See Secs. 156–158, 167; 11 U. S. C. §§ 556–558, 567.

There are strong indications in the record that extravagance and other serious mismanagement mark Fidelity's history (R. 440–473): Both the district court and the court below found "unsoundness in Debtor's methods of management" and referred to its "extravagant sales and promotion expenses; useless expenditures for lavish offices * * *; overexpansion, * * * poor judgment in selection of the personnel * * *;" (R. 195, 258–259). Auditor Sims, in the course of his testimony, stated that there was "stealing" of the company's assets (R. 441, 459), that the officers were guilty of "reckless squandering and spending" (R. 442), of "kiting salaries, making advances to salesmen in large sums, which they had not earned" (R. 472), that the officers of Fidelity were "incorrigibles" (R. 474), that he had called them "thieves and a bunch of brigands" (R. 476), and that "this is the roughest bunch I ever got

hold of. You can't save them from their own folly, in wasting their own money" (R. 477). Further, Fidelty consented, upon complaint filed by the Commission in December 1938, to a final judgment enjoining it, its officers, directors, and employees, from violations of the fraud provisions of the Securities Act of 1933.[21] And in the courts below, bitter recriminations and charges of personal self-seeking and of improper activities have characterized the course of this proceeding (see, e. g., R. 69–72, 472–473).

Whatever the validity of these charges, involving the *bona fides* and legality of the actions of Fidelity's management, their existence establishes the desirability of investigation of possible civil actions on behalf of Fidelity's estate against the officers, directors, and perhaps others. The investigatory processes and impartial trustee provided by Chapter X are particularly appropriate to fulfill this function as against the local procedures in this case, for the record indicates that the conflicting interests in the latter proceedings are such as to lack assurance of the thorough exploration which appears to be demanded. Problems of venue and jurisdiction would seem to be major, if not insuperable, obstacles to civil suits

[21] The text of the complaint, accompanying affidavits, and the final judgment are set out in the Report, *supra*, note 4, at pp. 197 ff. In Appendix C, Appendices pp. 6–9, we summarize some of the allegations of the complaint and affidavits relating to the financial practices of this company.

at the instance of the state officials in every state but West Virginia. In that state, the receivership proceedings were instituted by respondent Sims, after friendly consultation with, and with the consent of, Fidelity's officials (R. 410–412, 458, 603, 1187; Ex. 94). Although the firm of Koontz & Koontz, Fidelity's regular counsel (R. 574, 1136), appeared for Fidelity in the West Virginia proceeding instituted by Sims (R. 604, 690); Koontz & Koontz thereafter became, with Sims' acquiescence, the attorneys for the West Virginia receivers (R. 574). Indeed, one of the receivers, Ross Thomas, is an associate of the firm of Koontz & Koontz (R. 574, 1135), although Arthur Koontz, senior member of the firm, had long been a director of Fidelity, is one of the officers under indictment (R. 1167), and might be subject to liability if there is substance to these charges.

We submit that the interlocking relationships among the officials of Fidelity and the receivers and their counsel create divided loyalties which establish that the West Virginia receivership does not promise as adequate investigation and prosecution of causes of action against Fidelity's management as may be expected from the disinterested trustee appointed under Section 156 of the Bankruptcy Act, represented by a disinterested attorney appointed under Section 157, and assisted by a distinterested administrative agency under Section 208. The superior possibilities af-

forded under Chapter X for pursuing, on behalf of Fidelity's estate and the creditors, the remedies which appear *prima facie* to be appropriate alone warrant the conclusion that the Chapter X proceedings will subserve the creditors' interests better than the state proceedings, and justify the finding of the district court (R. 198) that it is not "reasonable to suppose" in the "light of all the facts and circumstances in connection with the state court receivership" that the directors' liabilities will be "diligently sought out and pursued," and that therefore the "best interests of creditors" would not be subserved in the prior proceedings. Since these findings were plainly supported, and since the persons involved were before the District Court as witnesses and participants, the findings should not have been rejected by the court below.

2. *The necessity for a single administration to settle problems of marshalling assets and of distribution.* The instant case presents complex and difficult problems of the respective rights of competing creditors. In contrast to the situation which obtained in *Marine Harbor Properties, Inc.* v. *Manufacturer's Trust Co.*, No. 24, this Term, decided November 9, 1942, there is here not a single class of local creditors with identical interests, but many classes of creditors with competing interests in the funds.[22] Fidelity has outstanding six dif-

[22] Respondent Sims alleged that if the so-called "trust fund" theory of Fidelity's assets be recognized, there are 117 classes of creditors (R. 75).

ferent series of contracts which were sold in 29 states and the District of Columbia (R. 179, 241). There are 88,000 contract holders residing in every state and in foreign countries (R. 242), and the net cash liability to each of these holders averages less than $273.[23]

The nature of these different claims presents a complex problem of creditors' rights involving the marshalling of assets and the determination of a number of doubtful legal issues. In the light of the great number of scattered creditors with these small claims, it appears plain that their interests will be best subserved by a single unified administration in which all the groups can settle the problems of marshalling, and distribute assets in an equitable and orderly manner, rather than by piecemeal, hasty, and inconsistent administration by a dozen sets of state officials and courts.

(a) *The problem of marshalling assets.* Preliminary to the problems of an equitable distribution there is the complex task of disentangling the assets of each of the several series in order that they may be properly and effectively marshalled. As we have described above (p. 6), the later series of contracts required Fidelity to segregate for the benefit of contract holders of the particular series the money paid by the holders of that series and the assets acquired by the use of such money. Although Fidelity maintained such segregation on

[23] The outstanding contracts represent an aggregate net cash liability of $23,475,668.67 (R. 242).

its books, assets were transferred from series to series in order to increase the book value of Fidelity's portfolio. Similarly, money was transferred from series to series, when needed to pay contract holders, for the purpose of avoiding the realization of loss on assets held by the borrowing series. These transfers were made on open book account. No series for which cash was borrowed has sufficient assets to pay both its contract holders and the lending series. Accordingly, before distribution can be made to Fidelity's contract holders, the accounts of the various funds *inter sese* must be settled. Unless this is done, assets which Fidelity was contractually obligated to segregate for one group of contract holders will be appropriated on behalf of another group of holders.[24]

The respondent state representatives take the position, in general, that the several states may apply their respective deposits among all of the contract holders secured thereby, without regard to the contract series to which the liabilities pertain or to which the deposited assets belong. But we believe that there is a problem whether states may retain securities accepted in disregard of

[24] Long before the present proceeding, Fidelity's officers and counsel indicated their own belief that the assets in the several contract series funds were in the nature of "trust funds" which had to be kept segregated and could not be used to meet the liabilities of other funds. See the excerpts from testimony and opinions of counsel in one of the affidavits in the injunction suit brought by this Commission, reprinted in Report, *supra*, note 4, at 225–228.

knowledge or notice that the assets deposited belonged to particular series funds and were deposited to secure liabilities of other series (*supra*, p. 9). Should this issue be decided adversely to the states in question, these states might not be able to retain their entire deposits even though some of their local security holders remained unpaid. Thus, these problems of marshalling assets are not dissipated, as the court below assumed (R. 261) merely by the fact that there would be little or nothing for nonresident creditors if the local deposits were distributed to local creditors without regard to series. The problems involved should be faced, not evaded by hasty distributions.[25]

We submit that the several prior proceedings, some judicial and some administrative, do not provide suitable *fora* for marshalling assets or for an accounting between funds. No state has power itself to marshall the corporation's aggregate assets, and determine the nation-wide liabilities of the several funds. It is obviously not feasible to do so by joint action of the several sets of state officials, nor likely that they would cooperate in

[25] The states have indicated frankly their intention to distribute the deposited assets among local contract holders without regard to fund segregation requirements (brief filed in court below on behalf of L. H. Brooks, *et al.*, pp. 13–14; brief filed in court below on behalf of Banking Commission of Wisconsin, *et al.*, p. 60). Such a facile disposition of the assets would leave unsolved the problems of interfund accountings and marshalling of assets by series.

view of their rejection of the "fund theory" of marshalling the assets (reply brief filed below on behalf of West Virginia, p. 41; brief in opposition filed by L. H. Brooks, *et al.*, p. 23). In contrast, the bankruptcy procedure, providing a single administration with all groups and all participants before it, and with the assets under its control, is better suited for the task of restoring the assets to the proper funds in accordance with Fidelity's contractual obligations.

(b) *The problems of distribution.*—Similarly, the difficult problems of conflicting creditors' rights can best be settled in a single administration.

There is a conflict of interests not only among the several series of contract holders (*supra*, pp. 35-38) but also between the resident and nonresident contract holders in respect of deposits in each state. These conflicts give rise to the following difficult questions which must be settled before there can be an equitable distribution:

(i) It must first be determined whether the state deposits are solely for the benefit of local residents and not for the benefit of all contract holders. Under the laws of some of the states, the answer to this question is by no means clear,[26] e. g., the

[26] This question seems to turn largely on the language of the local statutes (Appendix D, Appendices, pp. 10-74). The law has been stated as follows (23 Am. Jur. 468):

> Where, however, there is no expression in the statute which limits the benefit of the deposit to resident shareholders and creditors, nonresident creditors of such an insolvent company may be held entitled to

statutes of Kentucky, Missouri, Tennessee, and Virginia, Appendix D. In the domiciliary state of West Virginia, where the deposit is clearly intended to secure all creditors (R. 436–437, 1151) (Appendix D, Appendices, pp. 63–65), it must be determined whether West Virginia creditors have a preferential interest. We understand that the West Virginia authorities contend that such a preference exists, but we find no justification therefor on the face of the statute.

(ii) If the local deposit is for the benefit of local contract holders, it must be determined whether the critical date of residence is (1) at the time of the sale of the particular contract; or (2) at the time of the deposit, or (3) the present time. Since the local deposits are conditions precedent

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share in the distribution equally with resident creditors.

In the following cases resident creditors were denied preferential recourse to local deposits. *Davis* v. *Life Assn. of America*, 11 Fed. 782 (S. D. Ala.); *Holloway* v. *Federal Reserve Life Ins. Co.*, 21 F. Supp. 516 (W. D. Mo.); *Parsons* v. *Charter Oak Life Ins. Co.*, 31 Fed. 305 (S. D. Iowa); *American Bonding and Casualty Co.* v. *Chicago Bonding & Insurance Co.*, 251 Ill. App. 549 (1929); *Morrell* v. *Colonial Security Co.*, 101 Tex. 309, 107 S. W. 524 (1908). See also *Taylor* v. *Life Assn. of America*, 13 Fed. 493 (W. D. Tenn.). Cf. *People* v. *Granite State Provident Assn.*, 41 App. Div. 257, 58 N. Y. Supp. 510 (1899). In *Irwin* v. *Granite State Provident Assn.*, 38 Atl. 680 (Chancery Court of N. J. 1897), the court held that the statute dedicated the deposit to payment of local creditors but only to the extent of the proportionate dividend received by all other creditors as computed by the domiciliary receiver.

to the privilege of selling securities within the states, it is arguable that they are for the benefit of local *purchasers*, and some of the statutes require deposits to secure contracts sold in the state, rather than resident holders. But Fidelity for the sake of uniformity computed its periodic deposits in the various states according to the residences, at the time of the deposits, of its contract holders, as shown by the books (R. 757–758).

(iii) In addition, it must be determined whether the measure of the claims is (1) the cash value of the contracts, which is the only amount the contract holders could demand prior to the maturity of their contracts if Fidelity were a going concern, and the contractual minimum of the various contract funds and of most of the state deposits; or (2) the actuarial reserve liabilities under the contracts, which would be the amounts that ought to be on hand in order to pay the contracts according to their terms; or (3) the amounts which the contract holders actually paid in, which is the only measure which would give recognition to new contracts;[27] or (4) some

[27] It has been held, in the case of a contract somewhat similar to Fidelity's, that the creditor is entitled to recover the amount he has paid, with interest. *In re Bankers Mortgage Co. of Topeka, Kans.*, 83 F. (2d) 50 (C. C. A. 10). Cf. *Lovell* v. *St. Louis Mutual Life Insurance Co.*, 111 U. S. 264. In a case involving a fully paid endowment policy in an insolvent insurance company in liquidation, it was assumed that the policy holder's claim was the maturity amount discounted to present value. *Carr* v. *Hamilton*, 129 U. S. 252, 257–258.

other amount. The measure of damages not only determines the amount due to any individual but affects the amount of deficiencies to be satisfied elsewhere if possible, and thus affects as well the whole inter-relationship of resident and nonresident creditors in each state. In Wisconsin, for example, it appears that there may be a surplus over deposits if cash surrender value is the measure (Appendix A, Appendices, p. 2). There, as elsewhere, however, there are contract holders whose contracts have not yet achieved cash surrender value.[28] Thus, even were it assumed that residents are entitled to the local deposits, in the Wisconsin situation certain resident contract holders might receive nothing, and nonresidents may still be partially satisfied out of the Wisconsin deposit.

The presence of these questions, each with an impact upon the others, and all bearing upon the ultimate problem of making an equitable distribution to the persons legally entitled to satisfaction of claims and in the legally correct amount, underscores the inadequacy of the existing state proceedings. The course of this case establishes that there is little inclination among the state officials to litigate their conflicting rights *inter sese*, or to

[28] The contracts do not have a cash surrender value until after a substantial number of payments have been made. In the typical case, at least nine monthly payments were required (*supra*, p. 6; Ex. 1–5).

withhold distribution until contract holders can litigate the questions.

The state officials who appear as respondents in opposition to the bankruptcy proceedings are those representing states which are in a relatively good position in respect of their own deposits. These, therefore, are the states with an interest in keeping deposits for the benefit of local creditors, and with little incentive to establish possible rights of their own residents in the deposits held by other states (Appendix A, Appendices, pp. 1–2). The frank purpose of these depositaries is to avoid litigation of these questions and to make immediate distribution (*supra*, note 27).

But such a course would not only leave unsettled the conflicting rights among the states but, as a practical matter, would be likely altogether to deprive the contract holders from states with little or no deposited security of a forum in which they could litigate the questions presented. The intention, if realized, of the state representatives to proceed at once to distribute the assets without regard to the inherent problems might well result in the disposition of the assets before the contract holders even have time to begin the litigation of their rights. But even assuming that the contract holders can reach the courts while the assets are intact, other grave obstacles block the effective determination of the conflicting rights. The contract holders from

states without deposits and states with inadequate deposits must take the burden of obtaining the litigation of these questions in each of the states with sizable deposits. The geographical difficulties, the multiplicity of suits in different *fora*, the small size of the claim of each separate contract holder (*supra*, p. 3[illegible]), and the multitude of possible conflicts of interests among contract-holders which impede formation of large groups, strongly indicate that those who may be entitled to satisfaction of their claims, and who, at the least, are entitled to litigate these questions, will be eliminated by default unless an orderly central administration is provided. The issue on this branch of the case, is not, as stated by some of respondents,[29] whether the contract holders "would rather get 80% of their claims now than 85 or 90% ten years from now," but rather whether the assets are to be immediately distributed to those who may not be entitled to them, or whether the distribution is to be deliberate enough to permit a determination as to who is entitled to what amounts.

3. *The necessity of orderly procedure to liquidate the assets.*—A third separate factor establishing the desirability of Chapter X proceedings stems from the nature of the task of liquidation which would be presented. Fidelity's assets are such that

[29] Reply in Opposition to Memorandum of Securities and Exchange Commission, filed on behalf of respondents Brooks, Leake, Goldberg, and Godfrey, p. 32.

there is serious peril to a maximum realization upon them if each state depositary separately proceeds to immediate liquidation without regard to the over-all effect of simultaneous sale. The situation is plainly one which requires well-timed and skillful liquidation (R. 799–800), and the district court so found (R. 196–197). The trustee's report under Section 167 of the Bankruptcy Act (Report, pp. 29–30, see *supra*, note 6) shows that a substantial part of Fidelity's portfolio falls below the standard of high-grade and readily marketable securities. The analysis of Fidelity's portfolio in terms of ratings used by standard investment services shows:

| Rating | Amount, book value | Percent, book value |
|---|---|---|
| AAA–A [1] | $6,200,000 | 29 |
| BBB–B [2] | 8,500,000 | 39 |
| CCC–DD [3] | 2,355,000 | 11 |
| Not rated | 4,484,000 | 21 |
| Total | $21,539,000 | 100 |

[1] High grade.
[2] Good, medium, uncertain.
[3] Default threatened or existing.

Thus prime securities comprise less than one-third of the debtor's portfolio; medium and low grade issues, some of which are in default, constitute half of the total; and more than one-fifth are not rated. In addition the estate has a large office building in Wheeling, valued at $450,000 (R. 612), and other real estate (R. 612–614, 619).

With respect to certain securities, blocks held by the estate are so large and the market so thin (R. 799–800, 196–197) that throwing the securities on the market might greatly depress the price. For a maximum realization upon these assets, the portfolio must be liquidated in an orderly fashion unhampered by pressure for immediate liquidation and by competition by various state depositaries to exhaust the available demand. The process requires time and skill, and most of all freedom to exercise discretion as to the timing of sales and the selection of issues and quantities to be sold. After the decision below, the states attempted to meet the clear need by informal agreement for cooperative action of the officials involved (R. 279, 282). But the Chapter X proceeding is obviously superior to the several separate state proceedings for this purpose.

*Summary.*—We submit, therefore, that in the light of the facts indicating the need for independent trustees and an independent investigation, of the facts showing the desirability of an orderly marshalling and distribution, and of the facts establishing the need for a central administration, the District Court properly concluded that the interests of the creditors will not be best subserved by a continuation of the pending state proceedings. That many of the questions which must be litigated in the bankruptcy court may primarily be questions of state law should not affect this conclusion. Federal courts are, of course, frequently called

upon to determine questions of state law, especially in bankruptcy proceedings. *Erie R. Co.* v. *Tompkins*, 304 U. S. 64; *Fischer* v. *American United Life Ins. Co.*, 314 U. S. 549. See *In re Chicago & Northwestern Ry. Co.*, 127 F. (2d) 1001 (C. C. A. 7); cf. *Burgess* v. *Seligman*, 107 U. S. 20. In this case, where the issues involved present a conflict between resident creditors and out-of-state creditors, it is particularly appropriate that the federal courts should resolve the conflict.

B. *It is not unreasonable to expect that a plan of reorganization may be effected*

That, as the court below assumed, Fidelity is insolvent and the possibilities of its rehabilitation as a going concern may be negligible does not establish the unreasonableness of an expectation that a plan of reorganization may be effected within the meaning of Section 146 (3) of the Act (*supra*, p. 4).[30] On this issue, Fidelity's insolvency is not material, since Chapter X is expressly applicable to insolvent corporations. See Sections 130 (1), 179 (11 U. S. C. §§ 530 (1), 579); *Case* v. *Los Angeles Lumber Products Co.*, 308 U. S. 106, 131; *In re Central Funding Corporation*, 75 F. (2d) 256

[30] No question would be raised, of course, if Fidelity can in fact be reorganized as a going concern. Some of the respondents have stated that when the petition was filed Fidelity could have been reorganized on a going concern basis (R. 486; see reply brief filed below on behalf of West Virginia, pp. 34–36). If this be so, there clearly is no issue of good faith under Section 146 (3) and our discussion in the text becomes irrelevant.

(C. C. A. 2); *In re Julius Rockrs Co.*, 115 F. (2d) 723 (C. C. A. 3).

Nor would resort to Chapter X be foreclosed even on the assumption that the debtor may not be susceptible of reorganization on a going-concern basis. Other methods of disposition of assets would satisfy the requirements of a reorganization plan. And even if we accept the respondents' current contention that only liquidation is possible—a contention inconsistent with their earlier position (*supra*, note 30)—such a result is not fatal to good faith under Section 146 (3). For frequently a reorganization is appropriate to provide the machinery for liquidation and to take the debtor out of court. Liquidation cannot proceed indefinitely under the aegis of a court; yet the assets may be, as they are here (*supra*, pp. 4[illegible]), such as to require a deliberate and orderly liquidation without pressure. Cf. *In the Matter of Reynolds Investing Co.*, 6 S. E. C. 639 (1940). In contrast to ordinary bankruptcy or equity proceedings, Chapter X provides the means for creating a new corporation or other device charged with the duty of liquidating the assets as slowly as necessary and as expeditiously as is possible under the circumstances. This type of plan is a "plan of reorganization" under the Act. Cf. *In re Porto Rican American Tobacco Company*, 112 F. (2d) 655 (C. C. A. 2); *In re Central Funding Corporation*, 75 F. (2d) 256 (C. C. A. 2); *In re Mortgage Securities Corporation*, 75 F. (2d) 261 (C. C. A. 2); *R. L. Witters*

*Associates* v. *Ebsary Gypsum Co., Inc.*, 93 F. (2d) 746 (C. C. A. 5); *Continental Insurance Company* v. *Louisiana Oil Refining Corporation*, 89 F. (2d) 333 (C. C. A. 5). And such a plan may be the means of compromising the difficult problems of distribution pointed out above. Cf. *Consolidated Rock Products Co.* v. *Du Bois*, 312 U. S. 510.

We submit, therefore, that if other methods of reorganization be impracticable, then liquidation in an orderly fashion becomes important in this situation; that provision of the machinery for such liquidation constitutes a plan of reorganization within the meaning of Section 216 of the Bankruptcy Act (11 U. S. C. § 616); and that, accordingly, good faith is not lacking within the meaning of Section 146 (3).

## CONCLUSION

For the foregoing reasons, the decision of the court below should be reversed.

Respectfully submitted.

CHARLES FAHY,
*Solicitor General.*
RICHARD S. SALANT,
*Attorney.*

JOHN F. DAVIS,
*Solicitor,*
HOMER KRIPKE,
*Assistant Solicitor,*
JUSTIN N. REINHARDT,
*Attorney,*
*Securities and Exchange Commission.*

JANUARY 1943.

U. S. GOVERNMENT PRINTING OFFICE: 1943

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No. 319

# In the Supreme Court of the United States

OCTOBER TERM, 1942

FIDELITY ASSURANCE ASSOCIATION AND CENTRAL TRUST COMPANY, PETITIONERS

*v.*

EDGAR B. SIMS ET AL.

*ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT*

## APPENDICES TO BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION

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# APPENDIX A

*Market value of securities deposited in the various States segregated by series as compared with the net cash surrender liabilities in those States broken down by series* [1]

| | Income contract | Annuity contract | Series A | Series B | Series C | Series D | General fund | Total |
|---|---|---|---|---|---|---|---|---|
| West Virginia: | | | | | | | | |
| Deposits | $515.253.36 | $2,596,961.37 | $1,757,242.50 | $5,031,608.45 | | $671,901.65 | $100,828.75 | $10,674,[illegible]5.08 |
| Liabilities | 127,454.66 | 672,491.84 | 453,241.05 | 916,266.26 | | 12,227.94 | | 2,181,681.75 |
| Wisconsin: | | | | | | | | |
| Deposits | | 242,380.63 | 512,429.38 | 1,864,589.06 | | | | 2,619,399.07 |
| Liabilities | 3,025.59 | 401,762.98 | 185,096.95 | 1,752,257.34 | $509.96 | 325.85 | | 2,342,978.77 |
| Missouri: | | | | | | | | |
| Deposits | 15,187.50 | 293,360.00 | 121,534.37 | 423,988.75 | | | | 861,100.62 |
| Liabilities | 693.84 | 314,386.56 | 55,890.28 | 413,858.93 | | 2,153.75 | | 786,998.86 |
| Delaware: | | | | | | | | |
| Deposits | | 86,638.75 | 95,212.50 | 111,939.38 | | | | 293,790.63 |
| Liabilities | 19,613.34 | 52,202.67 | 88,099.12 | 130,040.73 | | 219.50 | | 290,175.36 |
| Iowa: | | | | | | | | |
| Deposits | | 35,497.50 | | 9,585.00 | | | | 45,082.50 |
| Liabilities | 1,943.39 | 16,686.06 | 10,239.31 | 5,471.51 | 138.00 | | | 34,478.27 |
| Alabama: | | | | | | | | |
| Deposits | 1,106.56 | 8,852.50 | 2,213.13 | 9,311.10 | | 11,071.87 | | 32,555.16 |
| Liabilities | 1,078.00 | 7,885.69 | 1,429.32 | 8,775.31 | | 12,178.39 | | 31,346.71 |
| Tennessee: | | | | | | | | |
| Deposits | | 48,414.38 | | 148,160.00 | | | | 196,574.38 |
| Liabilities | 2,923.07 | 33,073.73 | 608.30 | 163,100.37 | | 739.50 | | 200,504.97 |
| Maryland: | | | | | | | | |
| Deposits | | 71,187.50 | 212,733.75 | 186,885.00 | | | | 470,806.25 |
| Liabilities | 10,605.80 | 145,132.51 | 64,971.48 | 270,974.99 | | 867.46 | | 492,552.24 |

See footnote at end of table.

*Market value of securities deposited in the various States segregated by series as compared with the net cash surrender liabilities in those States broken down by series* [1]—Continued

| | Income contract | Annuity contract | Series A | Series B | Series C | Series D | General fund | Total |
|---|---|---|---|---|---|---|---|---|
| Kentucky: | | | | | | | | |
| Deposits | | 50,000.00 | | | | 38,712.50 | | 88,712.50 |
| Liabilities | 396.65 | 28,720.56 | 7,611.25 | 10,162.16 | | 45,799.80 | | 92,690.42 |
| Kansas: | | | | | | | | |
| Deposits | | 56,650.00 | | 26,687.50 | | | | 83,337.50 |
| Liabilities | | 65,928.25 | 3,563.00 | 39,149.64 | | 144.00 | | 108,784.89 |
| Illinois: | | | | | | | | |
| Deposits | | 512,047.50 | 505,316.50 | 2,742,530.00 | | | | 3,759,894.00 |
| Liabilities | 160,707.29 | 1,178,620.34 | 553,338.07 | 2,327,428.44 | | 5,606.61 | | 4,225,700.75 |
| Ohio: | | | | | | | | |
| Deposits | | | | | | 389,932.50 | 119,640.94 | 509,573.44 |
| Liabilities | 21,694.55 | 537,772.53 | 268,031.43 | 523,589.86 | | 1,009,330.43 | | 2,360,418.70 |
| Indiana: | | | | | | | | |
| Deposits | | 69,673.44 | 51,090.00 | 42,190.00 | | | | 162,953.44 |
| Liabilities | 4,995.53 | 63,732.59 | 27,504.13 | 288,091.08 | | 1,850.12 | | 386,173.45 |
| Virginia: | | | | | | | | |
| Deposits | | | 27,703.13 | | | | | 27,703.13 |
| Liabilities | 8,572.76 | 201,404.03 | 92,140.41 | 254,015.88 | | 1,674.11 | | 557,809.19 |
| Pennsylvania: | | | | | | | | |
| Deposits | | 121,896.25 | | 34,886.41 | | | 75,808.91 | 232,591.57 |
| Liabilities | 150,574.43 | 1,275,759.16 | 921,673.03 | 2,313,779.22 | | 6,796.41 | | 4,668,582.25 |

[1] Liabilities are stated at cash-surrender values as of Apr. 10, 1941, the day before Fidelity's receivership. These liabilities are based on obligations to present residents of the states. Fidelity's practice was to make deposits on the basis of liabilities to contract holders residing in the various states when the deposits were made (R. 758-759). Thus deposits have been made with respect to contract holders who no longer reside in the particular states, and some contract holders may now reside in states with substantial deposits, but which received little or no deposit with respect to liability to these contract holders.

Assets are stated at market values on June 6, 1941, the date of the petition under chapter X.

## APPENDIX B

*Covering letter and rider circulated by Fidelity in respect of insurance*

1.

Covering letter (R. 218–219)

DECEMBER 31, 1940.

DEAR CONTRACT-OWNER:

It is with pleasure and confidence that we direct your attention to the change in our name and the widening of the scope of our business to that of issuing insurance on the lives of persons. In the future, the company will be known as Fidelity Assurance Association and will offer a complete line of life insurance policies of all types and classes, including life annuities.

These changes enable us, as a qualified legal reserve life insurance company to assume the risks and obligations provided in Section 6 of your contract. As you know, this Section makes available to you insurance covering all monthly payments not yet made in event of your death. Such insurance protection has, in the past, been procured from a legal reserve life insurance company, but was subject to cancellation, upon due notice, at any time. With the making of your regular monthly payments and the Association

assuming the insurance, this condition has been eliminated.

By resolution of the Board of Directors and by the rider enclosed in duplicate, the Association assumes and itself agrees to fulfill and pay the risk and obligations of the insurance policy and of the insurance company mentioned in Section 6 of your contract. The original of the rider is to be signed and attached to your Income Reserve Contract, Series B and the other (the blue one) signed and returned to the Association in the enclosed envelope.

2.

Rider (R. 219)

FIDELITY ASSURANCE ASSOCIATION

ASSUMPTION OF RISK AND RIDER ATTACHED TO AND A PART OF INCOME RESERVE CONTRACT SERIES "B" NUMBER

The Association, having so amended its charter as to authorize it to issue insurance upon the lives of persons and every insurance appertaining thereto and to grant and dispose of annuities, and to change its name to Fidelity Assurance Association, in consideration of the monthly payments, provided for in the above numbered contract hereby assumes and does itself hereby agree to fulfill and pay all the risks and obligations of the insurance policy and the insurance company mentioned in Section 6 of said contract.

It is hereby agreed between the Association and the contract holder that this insurance agreement shall become and be a part of said contract and the original shall be attached thereto.

Executed in duplicate at Wheeling, West Virginia this 31st day of December, 1940.

FIDELITY ASSURANCE ASSOCIATION,

(S) F. S. RISLEY, *President.*

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*Contract Owner.*

## APPENDIX C

*Summary of allegations in the complaint and affidavits filed by the Commission in its action to enjoin Fidelity from violating the fraud provisions of the Securities Act of 1933 (see n. 21 of Brief)*

The following is a partial summary of the allegations in the complaint and affidavits in the action instituted against Fidelity by the Commission.[1]

1. At least since September 6, 1934, Fidelity has had to devise means of concealing on its books the fact that one of its assets is a worthless indebtedness to it of approximately $1,000,000 from National Sales Agency, Inc. From August 12, 1913, to September 6, 1934, the latter company had been exclusive sales agent for Fidelity's contracts. It was owned by Fred M. King. The indebtedness in question resulted from this corporation's practice of obtaining large monthly advances from Fidelity in excess of actually earned commissions. On September 6, 1934, Fidelity established its own "Agency Division". National Sales Agency, Inc.,

[1] The summary does not include allegations concerning fraudulent sales tactics by Fidelity's agents (see Report, n. 4 of Brief, pp. 211–218), but relates to allegations concerning Fidelity's financial practices.

thereby lost its only substantial source of income. Its principal assets were unsecured loans to Fred M. King, who was later discharged in bankruptcy. To maintain a semblance of value for the National Sales Agency, Inc., loans and to avoid recognition of the loss, Fidelity's "Agency Division" undertook to perform its sales functions for the account of National Sales Agency, Inc., and the "commissions" so "earned" were credited in payment of the note. (See Report, p. 236.)

2. (a) The National Sales Agency, Inc., note was transferred by Fidelity to two wholly-owned subsidiaries, Paull Company and Marston Corporation, at par.

(b) Fidelity also transferred to Paull Company and Marston Corporation foreclosed real estate and defaulted real estate securities at Fidelity's book carrying value, which was substantially in excess of market values.

(c) Paull Company and Marston Corporation issued to Fidelity their collateral trust bonds in face amount equal to the amounts at which Fidelity had transferred to them the securities referred to in (a) and (b) above.

(d) Fidelity deposited the collateral trust bonds of its subsidiaries with the insurance commissioner of West Virginia at face amount. By this device it was enabled to make deposits, although some of the assets underlying the collateral trust bonds were not acceptable for deposit under the West

Virginia law, and others of the assets were not acceptable for deposit in amounts equal to their book values. (See Report, pp. 206, 228–230, 239.)

3. Fidelity organized another wholly-owned subsidiary, Marietta Corporation, which built Fidelity's home office building. The funds were provided through the purchase by Fidelity of Marietta Corporation's preferred stocks and bonds. Fidelity was thus enabled to carry the bonds and preferred stock of its subsidiary as investments in securities, thereby concealing the fact that it had a large investment in home office real estate. It represented to the public that it had less than $50,000 worth of real estate investment. (See Report, pp. 207, 231, 232, 240.)

4. Fidelity speculated in the stock market on a margin trading account, using for that purpose monies "borrowed" by its General Fund from specific contract funds. (See Report, p. 241.)

5. Fidelity used the monies of contract funds and of the General Fund to purchase securities in so-called "special situations", in which its officers, directors and members of the investment committee were privately interested, and, in at least one instance, to the personal benefit of officers and directors. (See Report, p. 244.)

6. Fidelity purchased speculative securities at prices substantially below par. Under Sims' system of "sound value" (n. 23 of Brief), those which were not in default were accepted for deposit at

par by the West Virginia Insurance Commissioner. (See Report, p. 240.)

7. By "inter-fund sales" of securities at prices above book value, Fidelity created fictitious paper profits which enabled it to divert money from the various contract funds to the General Fund, and thence to stockholders as dividends. (See Report, pp. 207, 243.)

8. Fidelity's "Special Annuity Fund" had approximately $400,000 of "gains", representing the difference between the actuarial reserves and the cash surrender values paid out on lapsed Special Annuity contracts. Until 1937, these "gains" had been recognized as being part of the surplus of the Special Annuity Fund, to which contract holders of that fund were entitled when surplus was apportioned. In 1937, Fidelity withdrew this amount from the Special Annuity Fund and credited it to the General Fund, part being allocated to surplus and part being treated as income for the year. In addition to withdrawing the actual amount of these gains, Fidelity charged the Special Annuity Fund with interest at 4½% compounded semi-annually on each item of gain from the time it accrued until the funds were withdrawn. The legal and accounting fees and other expenses paid for computing these gains and interests, amounting to approximately $7,200, were also charged to the Special Annuity Fund. (See Report, pp. 242–243.)

## APPENDIX D

### STATE STATUTES WITH RESPECT TO DEPOSIT REQUIREMENTS AND TO RECEIVERSHIP AND LIQUIDATION, TOGETHER WITH RELATED TRUST AGREEMENTS

#### ALABAMA

*Code (1940) Title 53, Securities*

§ 1. (9878) *Definitions.*—When used in this title the following terms shall, unless the text otherwise indicates, have the following meanings: (1) "Security" shall include any * * * investment contract, income contract (which investment contract or income contract is issued for public offering as one of an issue of several like contracts), annuity contract unless issued by an insurance company, * * * investment trust debentures, units, shares, bonds and certificates in, for, respecting or based upon any form of securities or collateral, subscriptions and contracts covering or pertaining to the sale or purchase on the installment plan of any security as herein defined; * * * or any right to subscribe to any of the foregoing; or any instrument of any kind commonly known as a security.

§ 9. (9884) *Application for authority to sell filed with commissioner.*—The commissioner shall receive and act upon applications to have securities

admitted to record in such register of qualified securities; * * *.

§ 12. (9887) *Hearing on report to commissioner.*—After the report of investigation has been made upon any application, the commissioner shall examine such application and report of investigation, and shall give the applicant a public hearing, if he so desires. (1) If the commissioner shall report favorably to the applicant, he shall issue an order directing that such securities be admitted to record in the register of qualified securities, hereinafter provided for. The commissioner shall keep a permanent record of all its proceedings, findings, judgments and orders. In granting to an applicant the privilege of offering securities to the public in the State of Alabama, the commissioner may impose such reasonable conditions, either precedent, concurrent or subsequent thereto, as in the judgment of the commissioner may be necessary or advisable and may fix a time limit for compliance with such conditions or any of them. As one of such conditions precedent, the commissioner may, in his discretion, require that all or any part of the securities of the issuer, which have been or are to be issued for property or assets, either tangible or intangible, be deposited in escrow under such terms as the commissioner may prescribe. The securities deposited under such escrow agreement shall be released from such escrow agreement only at such time as the com-

missioner may deem just and equitable; and in any event such escrowed securities shall be released therefrom when the issuer's earnings shall equal those prescribed by paragraph (j) of section 4[1] of this title for the same class of securities. (2) [Grounds for refusal to admit securities to record in the register of qualified securities]. (3) But, no securities shall be admitted to record in the register of qualified securities until the applicant or applicants therefor have entered into a bond for not less than one thousand dollars, nor more than one hundred thousand dollars, and in no event for more than ten per cent of the aggregate selling price of the securities to be admitted to record. The amount of said bond shall be fixed by the commissioner in his order admitting said securities to record. Said bond shall be payable to the State of Alabama and be conditioned upon the truthfulness of the statements set forth in the application filed with the commissioner and of the written evidence or other probative matter filed with the commissioner in connection with such application and for the faithful compliance by said applicant and his agents with the provisions of this title and of any lawful condition or requirement made by the commissioner in granting such application. Said bond shall be made with a surety company authorized to do business in the State of Alabama and

[1] Section 4 (j) contains earnings and asset coverage tests for different types of securities.

shall be filed with and approved by the commissioner. Any original purchaser of such securities or other person injured by a breach of any condition in said bond shall have a right of action upon said bond for the amount of damages suffered thereby, but such right of action shall be barred unless suit be instituted thereon within one year from the time such cause of action arises. One or more recoveries upon such bond shall not vitiate the same; but no recoveries thereon shall ever exceed the full amount of such bond. Upon suits being filed in excess of the amount of such bond, the commissioner shall require a new bond; and if same is not filed with and approved by the commissioner within thirty days thereafter, the commissioner shall revoke the registration of the securities involved. All liability upon any such bond shall be extinguished upon the expiration of one year from the date of the last original sale by the issuer, or his agent, of any of the securities registered and authorized to be sold pursuant to the application on account of which such bond has been required by the commissioner.

§ 16. (9891) *Powers of commissioner to enforce provisions of Alabama securities law: examination and examiners: revocation of registration of securities.* * * *

(3) The commissioner shall revoke the registration of any security by entering an order to that effect, with his findings in respect thereto, if upon

examination into the affairs of the issuer of such security as provided by subdivision (2) hereof it shall appear to the commissioner, and he shall find (a) that the assets of any issuer, whose securities have been granted registration in the register of qualified securities, are impaired to such an extent that such assets do not equal seventy percent of its total liabilities, including its total stock liabilities reckoned upon the price at which such stock has been sold by such issuer to, or subscribed for by, the subscribers thereto; or (b) that the issuer has violated any of the provisions of this title or any orders of the commissioner or any term or terms thereof, or has failed to comply with any condition or conditions contained in any order of the commissioner within the time limit therein prescribed; or (c) that the issuer has been or is engaged or is about to engage in a fraudulent transaction or fraudulent transactions relating to or in connection with the sale of any securities; or (d) that the issuer is in any other way dishonest or has made any fraudulent representation or representations in any prospectus or in any circular or other advertising or literature that has been distributed concerning the issuer or its securities; or (e) that the issuer is insolvent; or (f) that said issuer has declared or paid dividends out of anything except the net earnings of said issuer actually received or accrued at the time of the declaration thereof, or out of accumulated surplus. * * *

*Collateral Trust Agreement*

This agreement made this 23 day of March, 1939, by and between Fidelity Investment Association, * * * party of the first part, and the First National Bank of Montgomery, * * * authorized to do a trust business in the State of Alabama, hereinafter referred to as the Trustee, party of the second part.

*Witnesseth*

WHEREAS, the Association has issued and sold pursuant to applications heretofore received from residents of the State of Alabama, certain certificates and contracts in form and substance in accordance with exhibits filed with the Securities Commission of Alabama, constituting all forms of contracts or certificates heretofore issued and sold.

And, whereas, the Association is now authorized to accept applications from residents of the State of Alabama, for its contracts and certificates, in form and substance in accordance with exhibits filed with the Securities Commission of Alabama.

And, whereas, the Association agrees to keep and maintain securities in the manner and to the extent hereinafter provided, and said Trustee agrees to accept and hold in trust said securities under the terms and conditions hereinafter set out:

NOW THEREFORE, in consideration of the premises, it is agreed as follows:

505126—43——3

ARTICLE I

That in order to further secure the contract and certificate holders of the Association whose contract and/or certificates have been issued and sold and are to be sold by the Association to residents of the State of Alabama, and in consideration of the sum of Five Dollars ($5.00), paid by the Trustee to the Association at or upon the delivery of these presents, the receipt whereof is hereby acknowledged, the Association has assigned and transferred and by these presents does assign and transfer to the Trustee, certain securities as hereinafter defined.

TO HAVE AND TO HOLD, in trust, for the holders of all contracts and all certificates issued and to be issued by the Association to residents of Alabama, and in accordance with the terms and conditions herein provided, the trust securities transferred and assigned and to be transferred and assigned to the Trustee, under the provisions of this agreement, shall constitute a separate and exclusive trust fund for the holders of the contracts and certificates, and for none other, and shall not be available to general creditors nor to any creditors of the Association, except as provided herein.

The securities, as the term is used herein, shall constitute the trust fund, and shall consist of: (1) cash, (2) bonds of the State of Alabama, (3) U. S. Government bonds, (4) bonds or debentures guar-

anteed or secured both as to principal and interest by the United States Government, (5) mortgage and deeds of trust insured by the Federal Housing Administrator under the provisions of the National Housing Act as the same is now in force or as the same may hereafter be amended, and (6) first mortgages on improved real estate located within the State of Alabama which improved real estate shall have been first appraised and valued by the Alabama Securities Commission or its agent and approved as to title by Alabama attorneys selected by the Securities Commission of Alabama. In no event shall the value of first mortgages on improved Alabama real estate exceed the appraised value placed on the property covered by sue mortgage by an appraiser selected and designated by the Alabama Securities Commission.

The Association covenants and agrees that the contracts and certificates mentioned above constitute all forms of contracts and certificates issued by the Association prior to the date of this trust agreement, pursuant to applications from residents of Alabama, and that the spirit of this agreement is that it shall also cover all contracts and certificates issued in the future.

Except as provided hereinabove in this article (subsection 6) for the purposes of this agreement, the trust securities assigned and to be assigned shall have the following value:

The value of promissory notes representing obligations secured by duly recorded first mortgages, or first deeds of trust on improved real property, shall be the unpaid balances thereon, less all payments made on account of principal and interest, and plus accrued and unpaid interest thereon.

The value of all government bonds, government debentures, and state bonds, shall be the purchase price of such bonds, or debentures, that is, the cost to the Fidelity Investment Association of such bonds or debentures, provided, all bonds or debentures in the trust fund shall be purchased at the current market price (on the date of purchase), and the said price shall be reported to the State Securities Commission at the time such bonds are transferred by the Association to the Trustee.

The total value of the securities held in trust by the Trustee shall be not less at any time than the liability of the Association upon all the certificates and contracts issued by the Association to residents of the State of Alabama, and the first installment of securities placed with and transferred to the Trustee shall be in amount not less than $21,988.96 as shown by the statement heretofore filed by the Association with the State Securities Commission of Alabama.

## Article II

[Provision for delivery of supplemental documents of title]

When transferred and assigned to the Trustee, the securities and related papers and documents shall be held by the Trustee subject to the provisions of Article VI and other applicable provisions of this trust agreement, so long as liability of any kind on the part of the Association exists, upon any of the contracts or certificates issued or to be issued or sold to residents of the State of Alabama. It is not the intention of this agreement to require the Association to transfer to the Trustee at any time securities in amount and value in excess of the amount and value provided on page three of Article I hereof. Substitution of and withdrawal of securities shall be done in the manner provided hereinbelow.

Interest coupons, if any, shall be surrendered by the Trustee to the Association on written request of the Association, not more than fifteen (15) days prior to their respective maturities.

## Article VI

If either of the following events hereinafter called "events of default", shall happen, that is to say:

[Specification of "events of default"]

Then, on the happening of either event, except default number three, specially provided for in this Article (VI) hereinbelow, the State Securities Commission shall demand and shall receive from the Trustee the securities transferred under this trust agreement without court action of any kind. The Association and the Trustee hereby agree that upon the happening or occurrence of either event, except event number three,[2] the Trustee will deliver the securities held hereunder to the State Securities Commission, upon written demand to the Trustee, pointing out the default, and the fact that notice of such default has been given as required hereunder, and it is agreed that the State Securities Commission shall forthwith administer and liquidate the securities received from the Trustee, for the benefit of Alabama investors, irrespective of the rights of any Trustee in Bankruptcy or Receiver for the Association. It is the intention of this instrument that in the event of the happening of either of the defaults enumerated in this Article (except number three), the State Securities Com-

[2] Event of default number three is as follows:

"(3) Should the Association fail in any of its covenants and agreements contained in this trust agreement and should said default continue for a period of fifteen (15) days, after notice in writing from the State Securities Commission or Trustee to the Association, calling attention to such default or defaults. (See special provision of Article VI.) : or,"

* * * * *

[Signatures]

mission shall take possession of the securities held by the Trustee under this agreement, and administer and liquidate the same, to the extent necessary to insure full protection for the Alabama investors, and independently of any rights of a Trustee in Bankruptcy or any receiver for the Association. The State Securities Commission is also hereby expressly given the right to administer and liquidate the securities received from the Trustee, for the benefit of all of the Alabama contract holders of the Association, as an adverse claimant, within the meaning of the Bankruptcy Act. If, however, the default should occur under subsection three of this Article (Article VI), then and in that event the State Securities Commission shall select $10,000 in value and amount of such securities, as a penalty for the failure on the part of the Association to carry out the terms of this trust agreement, and the State Securities Commission shall reduce such securities to cash and place the same in the general fund of the Alabama State Treasury, to the credit of the State Securities Commission, and such money shall be used by the State Securities Commission for carrying on, administering and enforcing the securities laws of the State of Alabama. But such penalty shall not be exacted until the Circuit Court of Montgomery County, Alabama, in a proper suit, has decided that the Association has failed, after due notice, to comply with the covenants and agreements contained in this trust agreement.

## DELAWARE

*Revised Code (1935) ch. 66, art. 7—Banks, Savings Societies and Trust Companies*

*Receiving Deposits or Payments on Income Contracts, Certificates or Bonds*

2360. SEC. 103. *Unlawful to Solicit or Receive Deposits or Payments on Income Contract, &c.; Without License From State Bank Commissioner; Not to Apply to Certain Business:*—No person, co-partnership, association or corporation shall engage in the business of soliciting or receiving deposits or payments on any income contract, annuity contract or certificate, or annuity bond, in fixed and stipulated installments, within this State, without first having obtained from the State Bank Commissioner a license to do business in this State. * * *

2362. SEC. 105. *Deposit Must Be Made With State Bank Commissioner Before License is Issued; Amount of Deposit; Additional Deposit May Be Required.*—Before any license to engage in the business described in the first clause of Section 103 hereof shall be issued the State Bank Commissioner shall require the applicant for such license to deposit with the State Bank Commissioner, in trust, for the benefit of its contract holders (or if such applicant be a non-resident person, co-partnership or association, or a foreign corporation, then for the benefit of its contract holders resident

in the State of Delaware) interest-bearing bonds or other income-producing securities, satisfactory to the State Bank Commissioner, to the market value of one hundred thousand dollars ($100,000.00); provided, that if at any time the State Bank Commissioner shall, in his discretion, determine that such deposit is insufficient for the protection of the contract holders, having regard to the obligations of the licensee, such licensee shall, on demand of the State Bank Commissioner, forthwith deposit with him such additional securities as he shall require, not exceeding in amount one hundred percent of its obligations (or if such licensee be a non-resident of this State or a foreign corporation, then it shall deposit with him such additional securities as he shall require not exceeding one hundred percent of its obligations to contract holders resident in the State of Delaware).

Should any person, co-partnership, association or corporation to whom such license shall have been granted cease, for any reason or cause whatever, to do business in this State, such deposit or deposits shall be returned to such licensee; provided, however, that retention may be made of a portion of said deposits, equal to obligations or liabilities outstanding to contract holders, until the State Bank Commissioner shall have been satisfied, by such evidence as he shall deem sufficient, that all obligations to contract holders shall have been fully paid and discharged (or, if such licensee be a non-

resident of this State or a foreign corporation, then that all obligations to contract holders resident in this State shall have been fully paid and discharged). * * *

2363. SEC. 106. *State Bank Commissioner to Examine Affairs of All Licensees; Commissioner Shall Have Like Authority As in Case of Banks, &c; Copies of Books, &c.; May Be Required, When; Expenses to Be Paid by Licensee:*—The State Bank Commissioner shall, at least once in every year, examine the affairs of all persons, co-partnerships, associations and corporations to whom he shall have issued a license to do business under this Article, and shall certify to such licensee so examined the result of such examination. * * *

2365. SEC. 108. *Upon Failure to Comply With Provisions, State Bank Commissioner May Revoke License After Five Days Notice to Licensee*—Upon the failure of any person, firm, association or corporation to whom a license shall have been issued under Section 103 hereof, to comply with any of the provisions of this Article, or if the State Bank Commissioner shall determine that the affairs of any such person, firm, association or corporation are in an unsound condition financially, the State Bank Commissioner is authorized to revoke or suspend the license theretofore granted by him to such a person, co-partnership, association or corporation, provided, however, that not less than five days' notice has been given said licensee

of such intended revocation, and opportunity for hearing afforded.

ILLINOIS

*Jones Illinois Statutes Annotated (1942 Cumulative Supplement, Volume 2)*

SECTION 13.07. *Investment Contracts Defined—Liquidation of Securities by Secretary of State.* § 6a. * * * No such investment contracts shall be sold or issued in this State unless the issuer shall deposit and maintain with the Secretary of State of this State, for the benefit of the holders of such investment contracts a deposit of securities in which life insurance companies organized under the laws of this State are permitted to invest their funds in an amount not less than fifty thousand dollars ($50,000), and at no time less than the issuer's current contract liability on all such outstanding investment contracts as defined therein, heretofore or hereafter sold in the State of Illinois, * * * The State Treasurer of this State shall hold as custodian for the Secretary of State, the securities deposited with the Secretary of State for the benefit of the holders of the investment contracts coming within the provisions of this Section 6a.

* * * * *

Upon the insolvency of the issuer or appointment of a receiver or trustee in bankruptcy, the Secretary of State or his successors in office may apply to the Circuit Court of Sangamon County,

or any other court of competent jurisdiction, for authority to proceed with the liquidation of such securities held for the benefit of the holders of such contracts in his office. The Secretary of State is hereby authorized to deal with such securities on deposit in this State for the benefit of the holders of such investment contracts, in his name, or, if the Court shall so order, in the name of the issuer. The Secretary of State may, subject to the approval of the Court, sell or otherwise dispose of the securities so deposited or any part thereof. He shall as soon as may be conveniently possible, give notice by publication as provided by law, and as the Court may direct, to all contract holders who may have claims against the issuer under such investment contracts and for whose benefit such deposit is held, to file and prove their claims in the manner and within the time the Court shall direct. In order to preserve so far as possible the rights and interests of the holders of contracts of such issuer sold in Illinois, he may liquidate such securities on deposit in this State by entering into contracts with any issuer or person able to buy such securities in whole, or in part. Upon receiving an offer or offers for the purchase of such securities in whole, or in part, the Secretary of State shall submit such offer or offers to the court, and if, after a full hearing upon the petition filed by the Secretary of State, the court shall find that the Secretary of State endeavored to obtain the

best contract price for the benefit of said contract holders, and if the court shall find that the best contract price in the interests of said contract holders has been obtained, and that it is for the best interests of said holders of such contracts that such securities be sold, the court shall, by written order, approve the acts of the Secretary of State and authorize him to dispose of such securities. Upon the conversion of such securities to cash, the Secretary of State may then proceed to dispose of the sum received for such securities among the respective holders of such contracts as their interest may appear. Upon the liquidation and distribution of such funds, the Secretary of State may make proper application to the court for final approval of his action in the liquidation of such securities and the distribution or disposition thereof or of the proceeds therefrom as herein provided. * * *

INDIANA

*Burns Indiana Statutes (1933) Volume 6, Chapter 38—Foreign Investment Companies*

25-3801 (8032). *License required.*—It shall be unlawful for any corporation, association or society organized under the laws of any state (other than the state of Indiana), or of any government foreign to the government of the United States, to conduct or engage in the business of a trust or investment company for the purpose of issuing its

stocks, bonds, contracts or agreements to its members or other persons, upon which payments are to be made in instalments, or for the purpose of receiving deposits or payments of money for any purpose, without first procuring a certificate of authority from the auditor of state, which certificate shall be renewed annually.

25–3803 (8034). *Deposit of Securities.*—Every such corporation, association or society, before the auditor of state shall issue his authority to do business, shall deposit with said auditor of state stocks or bonds, approved by said auditor, in a sum not less than twenty-five thousand dollars ($25,000), which amount shall remain in possession of said auditor for and during the first year that said corporation, association or society shall do business. At end of said first year, said corporation, association or society shall deposit with said auditor of state stocks or bonds approved by said auditor equal to the amount of its liabilities to citizens of this state and shall keep such deposit at all times equal to such liabilities.

25–3804 (8035). *Revoking authority.*—Any time such corporation, association or society, shall fail to make such deposit, as required by section three (§ 25–3803), or shall become insolvent or fail to carry out its contracts or agreements with citizens of this state, then said auditor of state shall revoke its authority to do business in said state, and shall ask the proper court of this state to

appoint a receiver to take charge of such deposit for the benefit of its creditors in said state.

*Note:* Sections 25–3801, 25–3813 were repealed by Acts 1935, ch. 179, § 18. Acts 1935, ch. 179, § 18 was repealed by Acts 1937, ch. 120 § 23.

IOWA

*Code (1939) Chapter 392, Sale of Stock on Installment Plan*

8517. *Terms defined.*— * * * The term "stock" shall mean * * * or other investment securities or agreements of any kind or character issued upon the partial payment or installment plan.

8521. *Bonds or securities deposited.*—Before any association shall be authorized to transact business contemplated by this chapter, it shall deposit with the commissioner of insurance a bond approved by the commissioner of insurance, guaranteeing the faithful performance of all contracts enfered into by such association or securities of the kind designated in subsections 1, 2, 3, 4, and 5 of section 8737,[a] or such other securities as shall be approved by the commissioner of insurance in the amount of twenty-five thousand dollars, which amount shall remain in possession of the commissioner of insurance until the end of the calendar year in which the association shall first be author-

[a] Section 8737 lists certain types of permissible securities for investment of life insurance company funds.

ized to transact business. At the end of such calendar year, such association shall deposit with the commissioner of insurance securities of the kind above provided in an amount equal to all its liabilities to persons residing within this state and shall keep such deposit at all times equal to such liability; provided that at no time shall such deposit be reduced below twenty-five thousand dollars except at such time as such association shall be by law closing out its business and its liabilities shall have been reduced below twenty-five thousand dollars.

8520. *Annual report.*— * * * If at any time it shall appear that such association is doing an unsafe business or is insolvent the commissioner of insurance may revoke its certificate of authority authorizing it to transact business within the state until the first day of March of the following year. If at any time it shall appear that such association is doing an unsafe business or is insolvent the commissioner of insurance may revoke its certificate of authority to transact business and having revoked the certificate of authority of an association organized under the laws of this state, he shall report his action to the attorney general who shall at once apply to the district court or a judge thereof for the appointment of a receiver to close up the affairs of such association, and an injunction may issue in the same proceeding enjoining and restraining the association from transacting business in this state.

*Corrick's General Statutes Annotated (1935) Ch. 17, Art. 10*

17–1033. *Foreign associations permitted to do business in state; certificate of authority, prerequisites.*—Foreign building and loan associations doing business in this state shall conduct their business in this state in accordance with the laws of the state governing domestic associations, and no such association shall do any business in this state until it shall procure from the bank commissioner a certificate of authority to do so. To procure such authority, such association shall comply with the following provisions: 1st. It shall deposit with the bank commissioner fifty thousand dollars, either in cash or in bonds of the United States or of the state of Kansas, or of some county or municipal corporation in the state of Kansas, of par value, which has never defaulted upon its interest, or it may enter into a bond annually to the state of Kansas, to be approved by the bank commissioner, for the benefit of the parties doing business with said association, in the sum of fifty thousand dollars, with ten or more sureties, to be approved by the bank commissioner, or with an approved surety company as surety, conditioned for the performance of its subsequent contracts with its members in this state. * * *

17–1037. *Securities liable for claims; release.*—The deposit made with the bank commissioner shall

be held as security for all claims of residents of this state against said association, and shall be liable for all judgments or decrees thereon, and subject to the payment of the same, in the same manner as the property of other nonresidents. Should any association cease to do business in this state, the bank commissioner may release securities, in his discretion, after one year's notice of the fact, retaining sufficient to satisfy all outstanding liabilities.

17-1047. *Construction of term "building and loan associations"; submission of bylaws and plans for approval; penalty for failure to comply.*—That the term building and loan association, as used in the statutes of Kansas, shall be construed to include: * * * *Second,* corporations, associations, companies, copartnerships and individuals transacting the business of issuing or selling bonds, debentures, certificates, shares of stock or other papers by whatever name said instruments may be designated, whether said instruments are issued for money paid in advance or for money to be paid in installments, but with an intent either implied or expressed, that the proceeds or accumulated installments thereof and thereon or any part thereof are to be withdrawable or repayable with accumulated profits at some future fixed or indefinite date or maturity; *Provided,* That all payments made in advance or in installments, or otherwise, on any of the foregoing instruments shall be subject to the

same provisions for withdrawal or repayment as payments on building and loan association stock. All of the laws and regulations prescribed by the statutes of this state for the government and regulation of the business and affairs of building and loan associations shall apply to all such corporations, associations, companies, copartnerships and individuals. All such concerns shall come within the supervisory jurisdiction of the building and loan supervisor, and be subject to examination and supervision as provided by the laws of the state of Kansas for building and loan associations. All such corporations, associations, companies, copartnerships or individuals, who have not already done so, shall submit their bylaws and plans for the transaction of business to the bank commissioner of the state of Kansas for his approval within thirty days from the passage of this act, and from and after said date such corporation, association, company, copartnership or individual shall not transact any business until their bylaws and plans of doing business are approved by the bank commissioner. * * *

17-1032. *Insolvency; receiver; special deputy, bond.*—If upon examination of such association made by the building and loan supervisor or his deputy, or from any report made to the supervisor, it shall appear that any such association is insolvent, it shall be the duty of the supervisor, with the approval of the bank commissioner, to immediately

take charge of such association, its business and all property and effects thereof. Upon taking charge of any such association, the supervisor shall as soon as possible ascertain by thorough examination into its affairs, its actual condition. And whenever he shall become satisfied that such association cannot resume business or liquidate its indebtedness to the satisfaction of all its creditors, he shall report the fact of its insolvency and condition to the attorney general, who shall immediately upon the receipt of such notice, institute proper proceedings in the proper court for the purpose of having a receiver appointed to take charge of such association, and to wind up the affairs and business thereof for the benefit of its creditors and stockholders. The supervisor may appoint a special deputy to take charge of the affairs of an insolvent association temporarily until a receiver is appointed. Such deputy shall qualify, give bond and receive compensation the same as a regular deputy; such compensation to be paid by such association or allowed by the court as costs of the appointment of a receiver: *Provided*, That in no case shall any association continue in charge of such special deputy for a longer period than sixty days.

KENTUCKY

*Carroll's Kentucky Statutes Annotated (Baldwin's 1936 Revision) Ch. 72a, Art. 1*

§ 2223a–1. *Reserve fund to be provided; deposit with state treasurer; statement to be filed.*—Every

corporation of the character generally known as investment companies, organized, or which may be hereafter organized, under the laws of Kentucky, for the purpose of conducting the business of placing or selling certificates, bonds, debentures, certificates of interest, or other investment securities of any kind, on the partial payment, installment or any other plan of payment, and providing for the redemption and retirement of same, or any part thereof, and every company, partnership or association conducting such business in this state shall provide a reserve and redemption fund of not less than seventy-five percent (75%) of amount collected in premiums, for the benefit and protection of its investors, and so much of said fund as shall not be immediately distributed to investors shall be invested as hereinafter provided, and every such company, corporation, partnership, association or individual now doing such business in this state within ninety days after the passage of this act shall deposit with the state treasurer the total amount of its paid-up capital stock, and if said paid-up capital stock shall not amount to fifteen thousand dollars ($15,000.00), shall deposit in addition thereto enough of the reserve fund to make fifteen thousand dollars ($15,000.00), in cash, or in [List of approved investments]. Said fund so deposited shall be for the protection of investors in such certificates, debentures and other investment securities, wherever residing. Said company, corporation, partnership

or association shall within ninety days after the passage of this act also file with the treasurer of the Commonwealth a statement verified by its president and secretary, showing its assets and liabilities as fixed herein, its income for the preceding twelve months, the total amount passed to its reserve fund now on hand, the number of certificates or parts of certificates redeemed or paid, and the amount of money used therefor. And at the same time such corporation, company, partnership or association shall deposit with the treasurer in cash, or in bonds or such other securities as hereinbefore provided for, the amount passed to the reserve fund, as shown by said statement, which deposit shall be made each year until the total amount of the deposit with the treasurer shall be of the actual value of one hundred thousand dollars ($100,000.00).

§ 2223a–2. *License to do business; when to issue.*— * * *

§ 2223a–9. *Examination of company; when to be declared insolvent.*—The governor of the Commonwealth of Kentucky shall have the power, at any time that he may deem proper, to appoint expert accountants at the expense of any company, corporation, partnership or association operating under provisions of this act, to make an examination of its affairs, and if it shall be ascertained by said expert accountants that any company, corporation, partnership or association operating under

the provisions of this act shall not have assets sufficient to equal in value the reserve fund contributed by every contract in force, plus the interest at three and one-half percent (3½%) per annum compounded annually, said company shall be declared insolvent and its license revoked.

§ 2223a–10. *Conditions upon which it may begin business; retaliatory laws; deposits with treasurer.*—Every such corporation, company, partnership or association organized under the laws of any other state, which shall have made deposit with the proper authority of such state, or of any other state of the United States, either in cash or in acceptable securities, for the benefit and protection of all its investors, wherever residing, or which shall comply with the laws of this state upon the following conditions, to-wit: It shall file with the secretary of state of this Commonwealth a certified copy of its charter or articles of incorporation and a statement giving the location of its office or offices in this state and the name or names of its agents upon whom process can be served; and shall file with the treasurer a certificate from the proper authorities of the state in which it may have been organized, or had made such deposit, showing that the deposit aforesaid has been made; such corporation shall also, on or before the fifteenth day of January in each year, make an annual statement as required by this act, which shall be published as aforesaid; and shall furnish to the treasurer a

certificate from the proper officer of the state where it shall have been organized or have made such deposit, showing that the deposit herein required of companies organized under the laws of this state for the preceding year has been made with the authorities of such state for the protection of its investors; and upon so doing, it shall be entitled to a renewal of its license for one year from the expiration of that already held by it * * * and provided further, that where any such corporation, company, partnership or association organized in any other state shall have made a deposit in any other state of the United States for the protection of holders of its certificates, bonds, debentures, certificates of interest or other investment securities, wherever residing, less in amount than that required by the laws of this state, it shall, before doing business in this state, file a certificate of such deposit as herein required, and shall deposit an amount with the treasurer of this state which, together with the amount so deposited in such other state, shall make up the total amount required by this act to be deposited by said companies in this state; and provided, that when, by the laws of any other state, any such company shall have been required to make, and shall have made, a deposit in such state for the security of holders of its certificates, bonds, debentures, certificates of interest, or other investment securities in such state alone said company shall not be required to make a deposit in this state of its reserved fund

accruing from its certificates, bonds, debentures, certificates of interest, or other investment securities which, under the laws of such other states, are secured by special deposit in such state, and the holders of said bonds shall not be entitled to the benefit of the securities deposited with the treasurer of this state under this act.

*Agreement*

THIS AGREEMENT, made and entered into this 5th day of November, 1935, by and between FIDELITY INVESTMENT ASSOCIATION, * * * as party of the first part, and the FARMERS DEPOSIT BANK, of Frankfort, Kentucky, a corporation duly organized and existing under the laws of the State of Kentucky, party of the second part:

*Witnesseth*

WHEREAS it is necessary, in compliance with the requirements of the Securities Department of the State of Kentucky, for the purpose of doing business therein by the party of the first part, that certain deposits of securities be made and subject to the approval of the Securities Commissioner of the aforesaid State of Kentucky; and

WHEREAS, it would be more convenient and advantageous to the party of the first part to make deposit of securities with the party of the second part to the satisfaction of such regulation; and with the consent and approval of the said Securities

Commissioner of the State of Kentucky, now, therefore,

IT IS AGREED that the party of the second part shall entertain and undertake custodianship of said securities, as more particularly described in Schedule "A" attached hereto and made a part hereof, in the total sum of $10,000.00 face amount, and any additional amounts which may hereafter and from time to time be deposited hereunder, such securities being a part of the Special Fund created by the Fidelity Investment Association for the specific purpose of maturing and/or paying the amounts due or to become due, under the terms of the Income Reserve Contract, Series "D". It being understood and agreed between the parties hereto that any and all such securities so deposited hereunder, and the coupons pertaining thereto, shall be held for the Securities Commissioner of the State of Kentucky, and shall be delivered to the party of the first part only under the advice and directions of the Securities Commissioner by written order addressed to said second party. * * *

[Signatures]

The foregoing agreement for deposit and custody of securities is consented to and approved this 12th day of November, 1935.

EVELYN C. CLIFTON,
*Securities Commissioner, State of Kentucky.*

[Supplementary Agreement dated November 2, 1938, is immaterial for present purposes]

*Flack's Annotated Code, Volume 2—Article 48 A—Installment Accumulation Contracts*

219. (*Licenses.*) No company shall hereafter engage or continue, either directly or indirectly, in the business of issuing, negotiating, offering for sale or selling any contract payable on the installment plan, with or without definite maturity dates, which contracts contemplate the accumulating of money or funds for making loans or investments and undertaking or agreeing to pay or deliver at any future time any sum of money, contract, or other thing of value, without first having obtained a license as provided in this sub-title.

222. (*Deposits Required.*) No company licensed under the provisions of this sub-title shall at any time offer, negotiate, or sell contracts in the State of Maryland, unless and until such company shall have assigned to and deposited with the Treasurer of the State of Maryland or with some independent bank or trust company approved by the Insurance Commissioner, in trust, as security for all the holders of contracts or other obligations heretofore or hereafter sold, negotiated, issued or accrued in said company in the State of Maryland, bonds, coin or treasury notes of the United States of America, or interest or dividend paying bonds or stocks of this or any other State of the United States or of any county, incorporated city or other

corporation of this or any other State having legal authority to issue the same and not in default, or other securities approved by the Commissioner, having a market value of not less than $25,000, and at no time less than the aggregate contract liability of the company under all contracts heretofore or hereafter sold in the State of Maryland; provided, however, that all such securities shall have been approved in writing by the Insurance Commissioner before the same are deposited with the Treasurer of the State of Maryland or with such independent bank or trust company, and further provided that in the case of a non-resident company which shall annually produce a certificate of the insurance commissioner or other proper financial officer of the State in which such company is organized, setting forth that such company has deposited with him securities having a market value of not less than $25,000 and not less than the aggregate contract liability of the company to the holders of all contracts or other obligations heretofore or hereafter sold, negotiated, issued or accrued by said company in the United States, and that he holds said deposit in trust and on deposit, under and by the laws of the State in which he resides for the benefit of all the contract holders of such company in the United States, and that he is satisfied that the securities so deposited by such company and held by him are worth not less than $25,000 and not less than the aggregate contract liability of

the company to the holders of all contracts or other obligations heretofore or hereafter sold, negotiated, issued or accrued by said company in the United States, then in such case such company shall be excused from making the deposit hereinbefore required. When the value of said securities shall depreciate so that the market value of the deposit shall be less than hereinbefore required, additional securities shall be deposited in order that the deposit shall at all times be maintained in the amount of not less than that hereinbefore required.

229. (*Liquidation of Insolvent or Illegally Conducted Companies.*) Whenever the Commissioner shall have reason to believe that any company is insolvent, fraudulently conducted, or that its assets are not sufficient for carrying on the business of the same, or during any non-compliance with the provisions of this sub-title, it shall be his duty in addition to revoking the license of such company, to proceed against it as provided by Sections 52 to 63, both inclusive, of this Article, for the liquidation of insolvent or fraudulently conducted insurance companies.

52. (*Liquidation of Insolvent or Illegally Conducted Companies.*) Whenever the Insurance Commissioner shall have reason to believe that any insurance company doing business in this State is insolvent, or fraudulently conducted, or that its assets are not sufficient for carrying on the business

of the same, or during any non-compliance with the provisions of this Article, it shall be his duty to forthwith cause proper proceedings to be instituted in the name of the State of Maryland against any such company in a court of competent jurisdiction, for the purpose of obtaining an injunction suspending the business of said company and having the said court assume jurisdiction over the property and business of said company for final liquidation, and the court in which said proceeding is instituted shall be authorized to appoint the Insurance Commissioner or the Deputy Insurance Commissioner, Receiver of such company, provided, however, that no such Receiver shall receive any additional compensation for his services as Receiver, but shall be allowed clerical, traveling and legal expenses, subject to the court's order, and shall furnish such bond as the court may require.

61. The Commissioner may, subject to the approval of the court, sell or otherwise dispose of the real and personal property of the company, or any part thereof, or any interest therein, or any other assets of the company against which a proceeding is pending under Section 54 of this Article, and may sell or compound all doubtful or uncollectible debts or claims owing to such company, including but not limited to claims based upon assessments levied against members of mutual insurance companies.

*Revised Statutes 1929, Ch. 32, Article 13—Bond Investment Companies*

§ 5060. *Bond Investment Companies Required to Deposit Cash or Bonds With State Treasurer to Protect Investors.*—Every corporation doing business in this state as a bond investment company, or company to place and sell bonds, certificates or debentures on the partial payment or installment plan, shall and the same is hereby required to deposit with the state treasurer, in cash, United States or Missouri state bonds, or bonds of any county, municipal township or school bonds, or mortgage bonds secured by deeds of trust on unencumbered real estate which, together with the improvements thereon, shall be worth at least double the amount of said notes, or such parts of each of the above mentioned securities, so that the whole deposit will be equal to the sum of one hundred thousand dollars, and whenever the liabilities of such bonds, certificates or debentures in force on the books of the company shall exceed the sum of one hundred thousand dollars, said company shall make an additional deposit on the first day of January and July of each year a sum sufficient in amount to cover the excess liabilities accrued during the preceding six months, for the protection of the investors in such bonds, certificates or debentures.

§ 5063. *Receiver, how appointed—powers and duties.*—In case of the failure of any company covered by this article, the circuit court of the county or city in which the principal office is located, upon the application of one or more shareholders, shall appoint a receiver for such company, whose duty it shall be to wind up its affairs, liquidate its debts and distribute its assets, using therefor, upon the order of the court, the deposit previously made, to secure the shareholders, with the state treasurer, and the state treasurer is hereby authorized to pay out such deposit in accordance with requisitions made upon the state auditor by said receiver and approved by the court, upon the warrant of the state auditor.

§ 5065. *Attorney-general shall conduct proceedings—fees.*—Proceedings instituted under the provisions of this article shall be conducted by the attorney-general of the state, and in the name of the state of Missouri as plaintiff, at the relation of said supervisor. The jurisdiction of the circuit court and processes, pleadings and proceedings had in the cases instituted under this article, shall be the same as are now provided by law for the winding up and dissolution of insurance companies, so far as such provisions of law are applicable. * * *

In reference to insurance companies § 5937 provides:

*Distribution of deposits.*—Whenever any company has been or shall be adjudged insolvent,

or shall be or has been dissolved, if a distribution of its assets among its policyholders and creditors is or shall be decreed, it shall be the duty of the superintendent of the insurance department to hold all securities on deposit for the benefit of all policyholders in such company, whether the claims of such policyholders are in judgment or not, to reduce such securities to money, and when so reduced, to apply the same, less the expenses herein provided for, to the liquidation of policy claims pro rata; in case there should be any surplus after the payment of all policy claims in full, such surplus shall become a part of the general assets of the company. If the policy claimants are not paid in full out of the proceeds of said securities, they shall be entitled to share in the distribution of its general assets for the remainder of their claims, as is provided by this chapter, and as to said remainder shall not be charged with the amount received by them on their policy claims out of the proceeds of said securities: *Provided, however,* that when said securities have been deposited to secure registered policies or annuity bonds, as provided by this chapter, the proceeds of the securities so deposited shall be first applied to the payment of the registered policies and annuity bonds, for the security of which the same were deposited. * * *

*Note:* Article 13, Chapter 32 of the Revised Statutes of Missouri of 1929 was repealed by Laws 1941, page 328, effective ninety days after July 12.

*Memorandum of Agreement*

THIS MEMORANDUM, made this 7th day of September, 1932, by and between Fidelity Investment Association, party of the first part, and Dollar Savings and Trust Company, party of the second part, both parties hereto being corporations chartered, organized, and existing under the laws of the State of West Virginia, with principal offices in the City of Wheeling, West Virginia.

*WITNESSETH*

WHEREAS, it is necessary, in compliance with the statutory law of the State of Missouri for the purpose of doing business therein by party of the first part, that certain deposits of securities be made with and subject to the approval of the Security Commisioner of aforesaid State of Missouri; and

WHEREAS, it would be more convenient and advantageous to party of the first part to make such deposits with party of the second part to the satisfaction of such statutory requirements and regulations, and with the consent and approval of the said Security Commissioner, now, therefore,

It is agreed that party of the second part shall entertain and undertake custodianship of said securities in total sum of three hundred and three thousand dollars ($303,000.), the property of party of the first part, holding same for the Security Commissioner of the State of Missouri, upon and

under his advice and directions by written order to deliver said securities and/or coupons; * * * to permit the substitution or change of securities, and to accept additional securities, all of which to be done upon written order of said Security Commissioner.

* * * * *

[Signatures]

The foregoing Agreement for deposit and custody of securities is consented to and approved this 15th day of September, 1932.

(S) F. T. STOCKARD,
*Security Commissioner State of Missouri.*

[Supplementary Agreement of February 22, 1938 is immaterial for present purposes]

OHIO

*Page's Ohio General Code—Annotated, Volume 1, Chapter 2b: Supervisor of Bond Investment Companies*

SEC. 698. *Deposit with treasurer of state.*—Before doing business in this state, every bond investment company shall deposit with the treasurer of state one hundred thousand dollars in cash or bonds of the United States or of the state of Ohio, or of any county or municipal corporation in Ohio, for the protection of investors in the securities of such company. Such deposit shall be made out of the

paid-up capital stock of such bond investment company.

SEC. 699. *Purpose of such deposit.*—The deposit made by a bond investment company with the treasurer of state shall be held as security for all claims of residents of this state against such company, and shall be liable for all judgments and decrees thereon, and subject to the payment of such decrees in the same manner as the property of other non-residents. If such company ceases to do business in this state, the treasurer of state may release securities, in his discretion, retaining sufficient to satisfy all outstanding liabilities.

SEC. 699–1. *Deposits required of foreign bond investment companies* * * *.—In addition to the deposits mentioned in the next two preceding sections, each such company * * * shall deposit with the supervisor of bond investment companies, securities or assets * * * in an amount equal to the cash surrender value * * * on all contracts entered into on and after the effective date of this act by such companies with persons resident in the state of Ohio, and such bond investment companies are hereby required to maintain such deposits in such amounts as are equal to such contract liabilities.'

* * * * *

All deposits required under this section shall be held by the supervisor of bond investment companies for the protection and benefit of their contract holders who are residents of Ohio.

SEC. 628–30. *Special deposit claims.*—The owners of special deposit claims against an insurer for which a receiver has been appointed in a delinquency proceeding in this or any other state shall be given priority against their several special deposits, in accordance with the provisions of the statutes requiring the creation and maintenance of such special deposits. If there be a deficiency in any such special deposit so that the claims secured thereby are not fully discharged therefrom, the claimants may share in the general assets, but such sharing shall be deferred until general creditors, and also claimants against other special deposits who have received a smaller percentage from their respective special deposits, have been paid percentages of their claims equal to the percentage paid from such special deposit, it being the purpose and intent of this provision to equalize to this extent the advantage gained by the security provided by such special deposits.

SEC. 628–32. *Liquidation, etc., of special deposit and secured claims; surplus.*—The ancillary receiver of assets in this state of insurers domiciliary in other states and subject to delinquency proceedings therein shall, as soon as practicable, arrange the liquidation or other disposition of special deposit claims and secured claims proved in the ancillary proceedings in this state, and all remaining assets, after payment of expenses, he shall promptly transfer to the domiciliary receiver.

SEC. 641. *Sale and distribution of securities of defaulting companies.*—If any company, corporation, or association required by law to make a deposit with the superintendent of insurance, or other state officer, to secure the contracts of such company, corporation, or association, or for any other purpose, fails to pay any of its liabilities upon such contracts, or other obligations, according to the terms thereof after the liability thereon has been determined, or if such company, corporation, or association, having ceased to do business within this state, leaves unpaid any such liability or has become insolvent, the attorney general of the state, on behalf of the superintendent of insurance, or such other officer, and upon the application of any person entitled to participate in such deposit, or the proceeds arising therefrom, shall commence a civil action in the court of common pleas of Franklin county, making the company, corporation, or association, a party defendant, to determine the rights of all parties claiming any interest in such deposit, to subject the deposit to the payment or satisfaction of all liabilities and to distribute such fund among the persons entitled thereto.

PENNSYLVANIA

*Purdon's Statutes Annotated (Permanent Edition 1939), Ch. 28*

§ 782. *License required of certain corporations, etc., doing certain business.*—After the first day of October, one thousand nine hundred and twenty-

one, no corporation or person shall, whether or not operating under a declaration of trust or other agreement, engage or continue, either directly or indirectly, in the business, within this Commonwealth, of receiving single payments, regular installment payments, or contributions to be held or used in any plan of accumulation or investment, or of issuing, negotiating, offering for sale, or selling any contract on the partial payment or installment plan, or of assuming fixed obligations, or issuing, in connection therewith, a contract based upon payments being made upon installments or single payment, under which all or part of the total amount received is to be repaid at some future time, either with or without profit, unless such corporation or person is licensed to transact such business within this Commonwealth by the commission in the manner hereinafter provided.

§ 783. *Application for license; investigation; refusal or revocation of license.*—Every corporation or person, desiring to obtain a license under the provisions of this act, shall file with the commission, an application in writing in such form as may be prescribed by the commission. * * *

§ 784. *Deposit of security.*—No corporation or person shall be licensed under the provisions of this act unless and until it has deposited with the commission in cash or bonds of the United States or of the State of Pennsylvania or of cities, counties, boroughs, or school districts of this Commonwealth, or any other state of the United States,

approved by the commission, of the clear market value of one hundred thousand dollars ($100,000), as security for the fulfillment of its contracts made heretofore or hereafter with residents of Pennsylvania. * * *

§ 787. *Additional security.*—The commission may require every corporation or person licensed under the provisions of this act to set apart a fund, no portion of which shall be applied to the expense of such corporation or person, which shall consist of not less than ten per centum of the amount designated in each contract issued as applicable to the payment of the expenses of conducting the business of such corporation or person. Such fund shall be invested at the close of each calendar year, or oftener if the commission may require, in bonds of the character described in section four of this act,[4] and forthwith deposited with the commission, in the same manner and under the same terms as prescribed by said section, as additional security for the fulfillment of its contracts, provided such corporations[5] or person may deposit cash with the commission in lieu of securities.

§ 789. *Discontinuance of business.*—Whenever any corporation or person licensed under the provisions of this act shall desire to discontinue with this Commonwealth the business of the nature hereinbefore set forth and described, it may make appli-

[4] Section 784 of this title. [Editor's note.]
[5] Probably should be "corporation." [Editor's note.]

cation by petition to the court of common pleas of Dauphin County, setting forth its resources and liabilities within and without this Commonwealth, and particularly an itemized and complete list of the holders or owners of the outstanding contracts issued by such corporation or person, together with the last known address of such holders or owners, and, in each case, the total amount of the liability of such corporation or person thereon, if any, and thereupon the said court, after due hearing, of which the commission shall have such notice as the court may determine, may make such order as will permit the withdrawal of said cash or bonds deposited with the commission, or a part thereof, and will, at the same time, fully protect the rights of all persons owning or holding the contracts issued by such corporation or person.

**TENNESSEE**

*Williams' Code Annotated (1934), Volume 4, Chapter 4*

§ 6057 (3273a122). Statements and documents to be filed with the commissioner before transacting business; filing fee; deposit of securities.

* * * * * *

Provided, however, that if the securities offered or to be offered for sale in Tennessee be of the class known as "investment contracts", comprising the following: investment contracts, or annuity contracts other than those of qualified insurance com-

panies, or installment investment certificates, or securities of like kind, which contemplate that the issuer shall pay or deliver, or whereby the issuer agrees to pay or deliver, either absolutely or conditionally, to the purchaser or holder of the contract, certificate, bond or like security, a sum of money at a future time, either with or without interest, in consideration of a payment or payments made or contemplated to be made by such purchaser or holder, which securities are hereinafter referred to as investment contracts; the investment company, or issuer, domestic or foreign, upon written request of the commissioner of insurance and banking of this state, shall deposit and maintain with the said commissioner, for the benefit of the holders of such investment contracts, a deposit of securities in cash or its equivalent; but the commissioner of insurance and banking may, in his discretion, accept as said equivalent, such securities as domestic life insurance companies are permitted to invest their funds in under section 6204 as amended of the official Code of Tennessee, in amount not less than $10,000 and at no time less than 100% of the issuer's cash or current contract liability on all such outstanding investment contracts, as defined herein, sold in the State of Tennessee. The commissioner of insurance and banking of this state shall hold as custodian the securities deposited for the benefit of the holders of the investment contracts coming within the provisions of this section:

§ 6068 (3273a132). *Attorney-general shall apply for receiver, etc., when.*—Whenever it shall appear to the said commissioner that the assets of any investment company doing business in this state are impaired to the extent that such assets do not equal its liabilities, or that it is conducting its business in an unsafe, inequitable, or unauthorized manner, or is jeopardizing the interests of its stockholders or investors in stocks, bonds, or other securities by it offered for sale; or whenever any investment company shall fail or refuse to file any papers, statements, or documents required by this chapter, without giving satisfactory reason therefor, said commissioner shall at once communicate such facts to the attorney-general, who shall thereupon apply to the chancery court in the district where such company is located or is doing business or to a chancellor of said court for the appointment of a receiver to take charge of and wind up the business of such investment company; and if such fact or facts be made to appear, it shall be sufficient evidence to authorize the appointment of a receiver and the making of such orders and decrees in such cases as equity may require.

VIRGINIA

*Code of 1942 (Annotated) Chapter 147A, Title 34A, Blue Sky Laws*

§ 3848 (49). *To what securities applicable.*—(i) Shares, participations, rights or interests, by what-

soever name or term designated or described, in investment trusts and/or in any enterprise or project having the essential characteristics of what is commonly known as an investment trust, whether under the English or American theory or plan, and by whatsoever term or name known or called, and also the securities thereof for capital purposes.

* * * * *

§ 3848 (51). *Information and fees required of promoters; conditions precedent to offering securities for sale; bond required.*—(r) In any case the commission shall have the right to require of any promoter either before or after granting an authorization, or license, for the sale of securities, or land, a bond, the form whereof shall be prescribed and the surety approved by the commission, penalty whereof shall be fixed by the commission at not more than twenty per centum of the sales price of the securities or land proposed or authorized to be sold. The said bond shall be with surety and payable to the Commonwealth, condition that the facts set forth in the application for such authorization, or license, and in all other documents required by this act to be filed with the commission are true, and that the provisions of this act shall be strictly complied with, and that all moneys from the sale of such securities or land will be used for the proper purpose or purposes as set forth in the subscription contract and/or in the security sold and in the papers filed with the com-

mission; and that the contract of the promoter as set forth in subscription and/or in the securities issued will be complied with. Except when the surety offered is a surety company authorized to do business in this State, it shall be the duty of the commission to satisfy itself that such surety is amply solvent before accepting the same; provided that the commission may, in its discretion, permit some other form or method of giving the security contemplated by this provision in lieu of requiring a bond as provided.

§ 3848 (60). *Suits on bond.*—Any person who shall be induced to purchase any securities or land, such as are designated in section three [3848 (49)] of this act, by any promoter, by reason of any misrepresentation of any material fact concerning such securities or land, contained in said application or other documents submitted in connection therewith or furnished to the commission, upon its request, or in any other written or printed matter issued or used by said promoter or its or his agents in making such sale, or shall have suffered loss by reason of the fact that moneys paid by him to the promoter of such securities or land or to the promoter's agent, have not been applied to the proper purpose of the promoter as set forth in the subscription contract, the security sold, or the papers filed with the commission, or that the promoter has failed or refused to comply with his contract as set forth in the subscription contract and/or in the certificate or other evidence of the security issued

or land sold, shall have the right to bring action upon the bond provided for by this act or under any substitute agreement approved by the commission in pursuance of provisions of this act, and such bond or duly approved substitute therefor shall be security for such person for his losses; but such person shall not be entitled to recover more than the money paid, or the actual value of the property given, or the labor performed, in exchange for such securities or land, with legal interest from the date of the payment or the performance of the services or the transfer of the property. One or more recoveries shall not vitiate the bond or substitute therefor, but same shall remain in full force and effect, but no recoveries shall ever exceed the full amount of such bond or substitute therefor, and upon actions being commenced in excess of the amount of same, the commission may require a new bond, or substitute therefor, and if the same is not given or effected within thirty days, the commission may revoke the permit herein provided for, provided, however, that any suit or action instituted under this section shall be commenced within two years from the date of any such sale by such promoter or its or his agents.

*Agreement*

WHEREAS the Fidelity Investment Association has executed a certain bond dated August 8th, 1932, under the provisions of the Virginia Securities Law: and

WHEREAS, in lieu of sureties upon said Bond, the Association desires to deposit certain securities with a trust as security for the faithful performance by it of all its obligations under said bond; and

WHEREAS, under the said law the State Corporation Commission of Virginia may approve some form or method of giving security other than requiring a bond with sureties;

NOW, THEREFORE, be it mutually agreed between the Fidelity Investment Association, a corporation organized and existing under the laws of the State of West Virginia, as party of the first part; and the State-Planters Bank and Trust Company of Richmond, a corporation organized and existing under the laws of the State of Virginia, Trustee, as party of the second part, as follows:

1. The party of the first part agrees to deposit with the party of the second part, as trustee, $25,000 United States Treasury Bonds, 3⅛s June 15, 1949, but upon the specific trust and condition that said securities are deposited as security for the faithful performance by the party of the first part of its several undertakings under the above mentioned bond, only.

2. If the party of the first part ceases to carry on business in the State of Virginia, and its liabilities, whether fixed or contingent, as mentioned herein, shall have been satisfied, or shall have terminated, upon satisfactory evidence of the fact the

State Corporation Commission of Virginia shall direct the party of the second part to deliver to the party of the first part the securities of said party in its possession, or, if there be contingent obligations outstanding the said Commission shall direct the delivery of the amount of securities over and above the amount necessary to take care of said contingent obligations, should they be legally established.

3. If the said party of the first part fails to perform any of its obligations for which it has executed its bond, and has failed to pay the liability arising therefrom after the same shall have been ascertained by any agreement between the party of the first part and the party to whom it may be incurred, binding upon the party of the first part, or by judgment, order, or decree of a court of competent jurisdiction of the State of Virginia against the party of the first part, not appealed from, superseded or stayed, the party of the second part shall, upon the application of any person to whom the liability is due, proceed to sell at auction such an amount of the aforesaid securities as will pay the sum due and the expense of sale, and out of the proceeds of sale pay said sum and expenses.

* * * * * *

8. The party of the second part further agrees that the said securities will not be taken beyond the boundaries of this State, and will not be turned

over to the party of the first part without the consent of the State Corporation Commission of Virginia.

* * * * *

[Signatures]

Approved: STATE CORPORATION COMMISSION.
By THOS. W. OZLIN.

WEST VIRGINIA

*Code of 1937—Annotated—Chapter 33, Article 9 (Annuity Contracts).*

SECTION 3446 (SEC. 1). *License from Insurance Commissioner Prerequisite to Engaging in Business.*—No person, association or corporation shall engage in the business of soliciting or receiving deposits or payments on any annuity contract or certificate or annuity bond in fixed and stipulated installments, within this State, without first having obtained from the insurance commissioner a license to do business in this State: * * *

SECTION 3448 (SEC. 3). *Deposits to be Made with the Treasurer.*—Before a license to transact business in this State shall be issued by the insurance commissioner to any person, association, or corporation within the purview of section one (§ 3446) of this article, the insurance commissioner shall require the applicant to deposit with the state treasurer (in accordance with article five, chapter twelve of this code), in trust, for the benefit of its

contract holders, bonds of the state of West Virginia, or such other bonds, and securities including bonds issued by the West Virginia bridge commission as may be approved by said insurance commissioner, or both, to the aggregate amount of one hundred thousand dollars, and, in addition to such deposit, such person, association or corporation shall maintain at all times a deposit with the state treasurer of bonds and securities approved by the insurance commissioner to an amount equal to the total amount which such person, association or corporation may be liable to pay in cash to the holders of all contracts under the terms thereof at the time of the deposit: Provided, That when, by the laws of any other state, any such person, association or corporation shall have been required to make and shall have made such deposit in such state, equal or greater in amount for the benefit of contract holders in such state, upon the filing of a certificate to such effect from the proper officer in such state with the insurance commissioner of this State, such person, association or corporation shall not be required to make such deposit with the treasurer of this State for the benefit of its contract holders in such other state; and when the laws of any other state require such deposit less in amount, such person, association or corporation shall file a certificate from the proper officer in such state with the insurance commissioner of this State showing the amount of the deposit made, and shall deposit

with the treasurer of this State an amount which, together with the deposit made in such other state, shall make up the total amount required by this State to be deposited by such person, association or corporation, and such contract holders in such other state shall not be entitled to the benefit of the securities deposited with the treasurer of this State under this article, except so much of such deposit as may be made to complete the total amount required by this article where the law of any other state requires a lesser amount.

The insurance commissioner may require an independent appraisal, at the expense of the company, of any property on which it holds a mortgage or trust deed or any bond or other investment offered by such company for the purpose of complying with the deposit provisions of this article.

SECTION 3450 (SEC. 5). *Revocation of License on Failure to Make Additional Deposits or Insufficiency of Assets.*—On the failure of such person, association or corporation to deposit such additional bonds and securities with the state treasurer when so required by the insurance commissioner, the license to do business in this State shall be revoked by the insurance commissioner. Whenever the insurance commissioner, upon an examination of the affairs of any such person, association or corporation, finds that the liabilities of such person, association or corporation exceed the assets thereof, the insurance commissioner shall suspend

the license of such person, association or corporation until he is satisfied that the assets of such person, association or corporation are increased to exceed such liabilities.

SECTION 3455 (SEC. 10). *Authority of Insurance Commissioner; Control of Deposit Where License Revoked.*—The insurance commissioner shall have the same authority over every person, association, or corporation engaged in selling annuity contracts, certificates, or bonds, as over insurance companies, and if in his opinion the assets are impaired or such person, association or corporation is not complying with the law, said commissioner shall have authority to revoke the license of such person, association, or corporation to do business in this State, and, if such license is so revoked, the deposit or a sufficient amount of same, shall remain under the authority and control of the insurance commissioner until the total liability of all the contracts, certificates or annuity bonds or contracts issued by such person, association or corporation in this State is redeemed or settled.

*Chapter 33—Article 2*

SECTION 3325 (1) (SEC. 45). *Proceedings in Circuit Court of Kanawha County Against Insolvent Company.*—Whenever any company under the supervision and regulation of the insurance commissioner shall become insolvent or shall be in such financial condition as not to be able to pay its cred-

itors in this State, the commissioner of insurance may file a bill in the circuit court of Kanawha county for the administering of the assets of such company as an insolvent, and for the purpose of taking possession of its property in this State and the distribution of its assets among those entitled thereto according to their respective right.

*Note:* Article 9, Chapter 33 of the Code of West Virginia was repealed by Acts of West Virginia 1941, Chapter 46, March 8, 1941, in effect ninety days thereafter, and a new statute regulating face-amount certificate companies was enacted (W. Va. Code, c. 32, art. 3). Fidelity never qualified under this statute.

## WISCONSIN

*Statutes, Chapter 216, Investment Associations*

216.01 *Regulation.*—No person and no copartnership, association or corporation, whether local or foreign, heretofore organized or which may hereafter be organized, doing business as a so-called investment, loan, benefit, co-operative, home, trust or guarantee company, for the licensing, control and management of which there is no law now in force in this state, and which such person, copartnership, association or corporation, shall solicit payments to be made to himself or itself either in a lump sum, or periodically, or on the instalment plan, issuing therefor so-called bonds, shares, coupons, certificates of membership or other evidences

of obligation or agreement, or pretended agreement to return to the holder or owners thereof money or anything of value at some future date, shall solicit or transact any business in this state unless such person, copartnership, association or corporation, shall have first complied with all the provisions prescribed in chapter 215 of the statutes required of foreign building and loan associations authorized to do business in this state.

216.02. *Laws applicable.*—All provisions of said chapter 215 with respect to the supervision, control and conditions upon which foreign building and loan associations are permitted to do business in this state are hereby made applicable to and imposed upon persons, copartnerships, associations or corporations described in the first section of this act, the same as though they were foreign building and loan associations under said act, so far as such supervision, control and conditions can be made applicable to the particular business done by such persons, copartnerships, associations or corporations.

*Chapter 215, Building and Loan Associations*

215.38. *Deposit.*—No foreign building and loan association * * * shall issue its shares, receive moneys or transact any business in this state unless such association shall have and keep on deposit with the state treasurer, in trust for the benefit and security of all its members in this state, five hun-

dred thousand dollars to be held in trust as aforesaid until all shares of such association held by residents of this state shall have been fully redeemed and paid off and until its contracts and obligations to persons and members residing in this state shall have been fully performed and discharged; the securities comprising such deposit shall first be approved by the banking commission under the same rules and regulations governing the approval of securities of trust company banks; and upon such deposit being made the state treasurer shall issue a certificate therefor, and thereupon the banking commission may issue its certificate of authority to said association to transact business in this state.

215.395. *Increase of deposit.*—Whenever the commission shall find that the liability of any foreign building and loan association or any foreign investment association on shares or contracts then outstanding or contracted for by members or persons residing in this state, exceeds ninety per cent of the amount of the deposit required by section 215.38 and section 215.39, or exceeds ninety per cent of the amount of the deposit required by such sections and by any order issued under the authority of this section, exclusive in each case, however, of any such liability under any agreement existing, created, regulated or required by the industrial commission under chapter 108 or by any other department, commission or division of state

government under any other provision of law, the commission shall issue an order to such association or corporation requiring such association or corporation to deposit within thirty days with the state treasurer, an additional amount in cash or securities of the class mentioned in section 215.39, or such other securities as the commission shall require and approve. If such order is not complied with within thirty days, the commission shall revoke the certificate of authority issued to such association or corporation.

215.33. *Possession by banking commission.*—(1) *Conditions for taking possession.*—The banking commission may forthwith take possession and control of the business and property of any association to which this chapter is applicable whenever it shall find that such association:

(a) Is conducting its business contrary to law, or

(b) Has violated its charter, or any law, or

(c) Is conducting its busineess in an unauthorized or unsafe manner, or

(d) Is in an unsound or unsafe condition to transact its business, or

(e) Has an impairment of its capital, or

(f) Cannot with safety and expediency continue business, or

(g) Has suspended payment of its obligations, or

(h) Has neglected or refused to comply with the terms of a duly issued order of the commission, or

(i) Has refused to submit its books, papers, records or affairs for inspection to any examiner, or

(j) Has refused to be examined upon oath regarding its affairs.

(2) *Procedure on taking possession.*—Upon taking possession of the business and property of any such association the banking commission shall forthwith:

(a) Serve a notice in writing upon the president and secretary of said association, setting forth therein that it has taken possession and control of the business and property of said association. Said notice shall be executed in duplicate, and immediately after the same has been served, one of the said notices shall be filed with the clerk of the circuit court of the county where said association is located, together with proof of service.

(b) Give notice to all individuals, partnerships, corporations and associations known to the banking commission to be holding or in possession of any assets of such association.

(c) The banking commission may appoint one or more special deputy commissioners as agent or agents to assist in the duty of liquidation and distribution of the assets of one or more building and loan associations of whose business and property the banking commission shall have taken possession pursuant to the provisions of this chapter. * * *

(d) Upon taking possession of the property and business of such building and loan association, the

special deputy commissioner of banking is authorized to collect all moneys due to such building and loan association, and do such other acts as are necessary to conserve its assets and business, and shall proceed to liquidate the affairs thereof as hereinafter provided. He shall collect all debts due and claims belonging to it, and upon a petition approved by the banking commission and upon order of the circuit court of the county in which such association is located, may sell or compound all bad or doubtful debts, or do any act or execute any other necessary instruments and upon like petition and order may sell all the real and personal property of such building and loan association on such terms as the court shall approve. Such special deputy commissioner may, if necessary, enforce individual liability of the stockholders to pay the debts of such corporation.

(3) *Notice, allowance and payment of claims.*—[This section provides for notice by advertisement to all persons holding claims to present them to the special deputy commissioner of banking and making legal proof thereof, etc. There is a provision for notice by mail as well.]

(4) *Inventory of assets and statement of liabilities.* * * *

(5) *Adjustment of loans and withdrawal value of shares.*—[This section provides that the banking commissioner may fix the value of all shares subject to the approval of the circuit court of the

county in which the association is located. It likewise provides for appeal by any shareholder to the Supreme Court.]

(10) *Appeal.*—[This section permits the association to apply to the circuit court of Dane County to enjoin further proceedings by the banking commission. A hearing in reference to the matter is provided for.]

(11) *Reinstatement.*—Whenever the banking commission shall have taken over the possession and control of the business and property of any building and loan association, the same may resume business when and if:

(a) The owners of at least two-thirds of such association's dollar value of outstanding shares, execute a petition to such effect, the form of which shall be prescribed by the banking commission, and

(b) There is submitted to the banking commission by such shareholders or a committee duly selected by them, a plan for the reorganization and reinstatement of such association, and

(c) The banking commission recommends that control of the business and property of such association be returned to the shareholders, and

(d) The court in which such liquidation is pending, upon application of the banking commission, makes an order approving the banking commission recommendations, which order shall contain a finding that such association will be in a safe and sound condition when control is resumed by the shareholders.

(12) *Reinstatement Upon Restricted Basis.* Such building and loan association may also resume business upon a restricted basis, and upon such limitations and conditions as may be prescribed by the banking commission when approved by the circuit court in and for the county in which such building and loan association is located, upon application of the banking commission. Such restrictions and conditions may include, among others, a prohibition against the selling of new shares, reasonable restrictions upon withdrawals and the payment of other liabilities. Such association shall thereupon be relieved from the control and supervision of the banking commission as provided in this section, but nothing herein shall, in any manner, prohibit the banking commission from again proceeding against such association as provided herein.

U. S. GOVERNMENT PRINTING OFFICE: 1949

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Office Supreme Court, U.S.
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CLERK

No. 319

# In the Supreme Court of the United States

OCTOBER TERM, 1942

FIDELITY ASSURANCE ASSOCIATION AND CENTRAL TRUST COMPANY, PETITIONERS

*v.*

EDGAR B. SIMS ET AL.

*ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT*

## REPLY BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION

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## REPLY BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION

### INTRODUCTORY

In our principal brief we argued that the District Court properly approved the Debtor's petition and that the Circuit Court of Appeals committed error in reversing that determination, because the interests of creditors would best be subserved by administration of the assets under Chapter X. This brief is devoted to replying to the contention that the courts below *cannot* administer the assets held by state representatives.

That contention is made in various forms in the briefs of the Wisconsin, Iowa, Maryland, and West Virginia respondents and in the brief filed by representatives of 17 states as *amici curiae*. It was not passed on by the court below.

In summary, our position is as follows:

We do not contend that the rights created by the state deposits are destroyed or entirely superseded by the reorganization proceedings. We expressly concede that the state deposit laws are valid. We expressly concede that the rights created thereunder must be recognized and protected in the reorganization under the rule of *Case* v. *Los Angeles Lumber Products Co., Ltd.*, 308 U. S. 106, and *Consolidated Rock Products Co.* v. *DuBois*, 312 U. S. 510.[1]

The District Court recognized that rights created under the state deposit statutes should be preserved. The court said (R. 487):

> I have been able to see nothing in the petition which says that any vested rights of any contractholders are to be modified or need to be modified. My understanding of the allegation of the petition is that the contracts, the executory contracts of the company, contain provisions that the company cannot meet, and that in order

[1] Compare *In re Rosett*, 204 Fed. 431 (C. C. A. 2), where the State Comptroller of New York was required to surrender a deposit to the bankruptcy court but the preferences created under state law were recognized in bankruptcy.

> for any reorganization those executory contract provisions must be modified; but certainly there is no indication there that any vested rights in any deposits are going to be affected at all, and the Court would not permit that if there was any such thing contemplated. * * *

We do contend that the property on deposit remains the property of Fidelity, and that the *remedies* provided under the state deposit statutes for realization on the deposit are superseded by the bankruptcy power exercised under Chapter X of the Bankruptcy Act. Neither the Tenth nor the Eleventh Amendment precludes resort to the remedial procedures provided under the Bankruptcy Act in lieu of the remedies provided by state statutes or by contract.

A. THE DEPOSITED PROPERTY REMAINS FIDELITY'S PROPERTY OVER WHICH THE DISTRICT COURT HAS JURISDICTION

1. The assets on deposit with the state officials are Fidelity's assets. The state statutes vary in form, but there cannot, we submit, be any doubt that the deposits are for *security* purposes. The deposits are not themselves payments which reduce liability on the contracts, and upon full compliance with its contracts in any state Fidelity is entitled to a return of the deposit made in that state. In these circumstances, the deposits are Fidelity's assets, deposited by way of pledge

or mortgage, and this is so whether or not title to the deposited securities has been assigned.

To illustrate: In the domiciliary state of West Virginia (which holds about half of all the deposits), the statute (W. Va. Code, Ch. 33, Art. 9, sec. 3 [2]) requires the amount specified to be deposited "in trust, for the benefit of its contract holders." The purpose of this deposit is indicated by two other sections which empower the Insurance Commissioner (1) to revoke the license of the company and retain control of the deposit or a sufficient amount thereof until the total liability on all contracts issued by such company in this state is redeemed or settled (W. Va. Code, Ch. 33, Art. 9, sec. 10); and (2) to file a bill for the administration of its assets, for the purpose of taking possession of its property in this state, and for the distribution of its assets among those entitled thereto according to their respective rights (W. Va. Code, Ch. 33, Art. 2, sec. 45). *Sims* v. *Homeseekers Fire Ins. Co.*, 117 W. Va. 84, 183 S. E. 869 (1936).

These are the Insurance Commissioner's only alternatives in dealing with the deposited property upon insolvency of the company. The statutes give him no authority like that possessed by the sinking fund custodian in *Warder* v. *Brady*,

[2] The Tennessee, Wisconsin, and other statutes are similar. All statutes cited are set out in the appendices to our main brief.

115 F. (2d) 89 (C. C. A. 4), on which respondents rely.[1]

In the *Brady* case, when the company made a payment into the sinking fund, the payment reduced *pro tanto* the company's indebtedness to its bondholders. The deposit was accepted as payment. Hence, the court in that case found that a payment of money into the sinking fund "amounted to an appropriation [thereof] * * * to the purpose specified, so that the corporation parted with all title thereto." The deposit of property by Fidelity had no such effect, and it is that fact which distinguishes this case from the case of *Warder* v. *Brady*. Fidelity remained personally liable in the full amount of its contracts, and its contract holders looked to it as their primary source of payment. Obviously, it could not plead the value of its deposit as partial payment in a suit by a contract holder. In fact, Fidelity has always paid its contract holders directly and

[1] *In re Prudence Co., Inc.*, 82 F. (2d) 755 (C. C. A. 2), certiorari denied, 298 U. S. 685 (Md. Brief, p. 29), clearly rests on the fact that The Prudence Company, Inc., the debtor, was only the guarantor of the obligation for which the securities sought to be administered were pledged. The decision does not support the contention that collateral may not be administered in reorganization proceedings involving the corporation which is the primary obligor. This is shown by the fact that the court cited with approval *In re Prudence Bonds Corp.*, 79 F. (2d) 205, where it was held that the collateral could be administered in the reorganization of the principal obligor.

they have never had recourse to the fund. Had Fidelity completely paid its contract holders, it would have been entitled to a return of the deposited property. Certainly, any surplus would be neither the property of the state of West Virginia nor that of its officials; nor would it (as respondents have suggested, W. Va. Brief below, p. 61), be divided among contract holders whose contractual claims had been fully paid because that would be contrary to the explicit provisions of the statute and the contracts. In short, the property deposited is, at most, collateral security for the claims of contract holders and the deposit did not divest the company of its interest in the property. Cf. *United States* v. *Knott*, 298 U. S. 544, 550.

In Maryland the statute goes beyond the West Virginia and other statutes, but there is no difference in legal effect. Section 222 of Article 48A of the Annotated Code of Maryland (1939 ed.) requires that the company "shall have assigned to and deposited (securities) with the Commissioner * * * in trust, as security for all the holders of contracts * * * bonds * * * or other securities * * *." The provision for assignment does not change the fact that the deposited securities remain property of Fidelity deposited to secure its obligations. Legal title frequently passes in pledges. And it is customary in real estate mortgage indentures to "convey, bargain, sell, assign * * *" the

property to a trustee. There, as under the Maryland statute, the grantor is a residuary beneficiary of the trust. But clearly in such cases the property remains that of the grantor, subject to administration in its reorganization proceedings.

This was recognized in *In re Bajardi*, 8 F. (2d) 551 (S. D. N. Y.), affirmed, 9 F. (2d) 797 (C. C. A. 2). The statute there, in language like that in the Maryland Act, required every private banker to "transfer and assign to the superintendent of banks registered stocks or bonds * * *. Such stocks or bonds shall be registered in the name of the superintendent of banks officially as trustee for the depositors with such private banker * * *." See 9 F.(2d) 797. The statute involved in the *Bajardi* case further provided:

> Such stocks or bonds shall be registered in the name of the superintendent of banks officially as trustee for the depositors with such private banker, subject to sale and transfer and disposal of the proceeds thereof by the superintendent only upon the order of a court of competent jurisdiction * * *.

This is again similar to Section 224 of the Maryland statute, which provides:

> All deposits * * * shall be held by said Commissioner subject to sale and transfer and to the application of the proceeds of any such sale only on the order of a court of competent jurisdiction.

The district court in the *Bajardi* case held that the bankruptcy court in the administration of the assets was a "court of competent jurisdiction" with power, under the statute, to direct the Superintendent in the administration of the assets. The circuit court of appeals, despite the fact that the securities deposited with the Superintendent of Banks were registered in his name, recognized that they belonged to the bankrupt and summarily required their surrender to the bankruptcy court. It said (p. 799):

> The very purposes for which the deposit is required by the statute are sufficient to show that the stocks, etc., were regarded by the Legislature as the *property of the banker* for the payment of his debts to a specified class of creditors. [Italics supplied.]

2. The mere existence of the lien or other specific interest of the contract holders in the deposits does not preclude the exercise of jurisdiction over them by the court in reorganization proceedings under Chapter X. Even in "straight" bankruptcy proceedings, property pledged or mortgaged by the Debtor to secure its obligations is subject to the jurisdiction of the bankruptcy court. *Isaacs* v. *Hobbs Tie & Timber Co.*, 282 U. S. 734; *In re Schulte United, Inc.*, 49 F. (2d) 264 (C. C. A. 2). But in "straight" bankruptcy, liens cannot be affected, and accordingly property held by a mortgagee or pledgee or receiver cannot be

drawn into the possession of the bankruptcy court, except in circumstances not now material. In reorganization proceedings under Section 77B and Chapter X, the court's powers over such property are much broader. *Continental Illinois National Bank & Trust Co.* v. *Chicago, Rock Island & Pacific Ry. Co.*, 294 U. S. 648; *Warder* v. *Brady*, 115 F. (2d) 89 (C. C. A. 4); *In re Prudence Bonds Corp.*, 55 F. (2d) 262 (C. C. A. 2); *In re Prudence Bonds Corp.*, 77 F. (2d) 328 (C. C. A. 2). As the court below said in *Warder* v. *Brady* (p. 95):

> The bankruptcy court in reorganization proceedings under § 77B, 11 U. S. C. A., § 207, had, and under Ch. X of the 1938 Act now has a wider control, that comprehends not only property of the debtor in his actual or constructive possession, but also property of the debtor in the hands of lien holders. The formulation of a plan of reorganization contemplates a readjustment of secured as well as unsecured debts, and so the summary power of the court extends to all of the debtor's property that can be affected by a plan, whether or not the property is in his possession. * * *

The jurisdiction exercised by the district court is precisely that which the court in *In re Prudence-Bonds Corp.*, 77 F. (2d) 328 (C. C. A. 2), described as proper (p. 330):

> The court of reorganization can bring within its jurisdiction property covered by mortgage or pledge, when a plan covering it

has been adopted and confirmed. And prior thereto, property held by a pledgee, in which the debtor has an equity, is likewise within the court's jurisdiction, so as to prevent a disposition by foreclosure of the pledge or mortgage. For the purpose of reorganization, the court should take complete charge of property in order that it may from the beginning, and through all the intermediate steps of reorganization, so administer the property as to achieve the desired rehabilitation.

3. The fact that Fidelity is insolvent, and that the deposits are insufficient to pay the claims which they secure, does not destroy Fidelity's interest therein. Inadequacy of the deposit does not, without appropriate legal proceedings, act as a strict foreclosure or otherwise operate to divest Fidelity of its interest in the property. Moreover, insolvency does not alter the status of the property as collateral security for the debtor's personal obligations to its contract holders.[4]

4. Respondents are subject to summary orders of the district court with regard to property in their possession, because they are not adverse claimants. The mere assertion of an adverse claim does not oust the jurisdiction of the bankruptcy

[4] See *In re Prudence Bonds Corp.*, 79 F. (2d) 205, 209 (C. C. A. 2), where the argument was rejected that when the debtor became insolvent, it lost all interest in the deposit and that the deposited collateral could not be reorganized as part of its property.

court unless the claim is colorable. *Harrison* v. *Chamberlin*, 271 U. S. 191; *Warder* v. *Brady*, 115 F. (2d) 89 (C. C. A. 4).

We submit that here there can be no more than a "mere assertion" of an adverse claim, "so unsubstantial and obviously insufficient * * * in law, as to be plainly without merit," and accordingly, the district court could properly "dispose of it summarily." *Warder* v. *Brady, supra,* at p. 92.

In *Continental Illinois National Bank & Trust Co.* v. *Chicago, Rock Island & Pacific Ry. Co.*, 294 U. S. 648, this Court rejected the contention that an order enjoining pledgees from selling collateral in their hands, pending the preparation and consummation of a reorganization plan, could not be entered summarily, saying (p. 681):

> * * * The bonds deposited as collateral were not in the hands of purchasers, but in the hands of creditors as security. That the equity which the debtor retained was a property interest, was not and could not be disputed by the creditors; nor was the claim of the creditors in respect of their rights in the collateral security or the rank of their liens questioned by the debtor. In short, no adverse claim was brought forward by either of the parties to the controversy. * * *

Assertions that state officials like the respondents are adverse claimants have been overruled even in cases where title was held to have vested in the state officials. *In re Bajardi*, 8 F. (2d) 551 (S. D.

N. Y.), affirmed 9 F. (2d) 797 (C. C. A. 2) *supra*, pp. 7–8; *Gamble* v. *Daniel*, 39 F. (2d) 447 (C. C. A. 8).

In *Gamble* v. *Daniel*, it was argued that the Department of Trade and Commerce of Nebraska, which had taken possession of a bankrupt trust company for liquidation, was an adverse claimant to the bankruptcy court. The court overruled the contention, holding that the Department was in the position of an assignee for creditors, and as such was subject to a summary order. It said (pp. 453–454):

> There is no dispute as to the character of the possession here. Appellant claims no right in himself in this property. He claims as the agent of the department of trade and commerce. The possession is only under the statutes of Nebraska * * *. *This is purely a liquidating statute.* The possession of appellant is alleged to be and is only as a "liquidating agent" under such statute. *Such statute is analogous, in purpose and effect, to state statutes governing assignments for the benefit of creditors. For the matter here involved, the possession of appellant is entirely analogous to that of an assignee for the benefit of creditors under state law. It has been directly determined that such assignee is not an "adverse" holder and may be required, by summary order, to turn over property so held to the bankruptcy official.* * * * [Citing cases, italics supplied.]

In *Hobbs* v. *Occidental Life Ins. Co.*, 87 F. (2d) 380 (C. C. A. 10), a federal court having jurisdiction over the equity receivership of an insurance company approved a reinsurance contract and summarily ordered the Commissioner of Insurance of Kansas to deliver a deposit (held in the custody of the state treasurer) to the reinsuring corporation.

The court on appeal by the Commissioner, rejected his contention that a plenary suit was necessary. It said (p. 384):

> * * * Where property is held by a third person, that is one not a party to the action and he makes a claim of right or title in himself or on behalf of some other person not a party, and such claim is adverse to that of the receiver, a plenary suit is necessary to recover possession. But the commissioner does not advance a claim of that kind. He puts forward a right of possession as trustee for persons who are bound by the proceedings taken in this action. An independent suit is not required in these circumstances. His claimed right of possession may be determined in summary manner in this case. * * *

The Maryland brief (pp. 36-37) seeks to distinguish the *Hobbs* case on the ground that there the court had approved a reinsurance agreement which bound all unpaid beneficiaries of the deposit, so that the purpose of the deposit had been fulfilled. But in this case any plan confirmed will similarly

bind all beneficiaries of the state deposits;[8] the state officials have no interest of their beneficiaries to protect which will not be protected by the reorganization court.[9]

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[8] On this question *Miles* v. *New South Building and Loan Association*, 95 Fed. 919 (C. C., N. D. Ga., 1899), cited in the *Hobbs* case, is in point. That case involved a receivership in which the trustee of a collateral bond issue was summarily ordered to surrender the collateral to the court. The trustee objected that it was an adverse claimant. The court held (pp. 921–922):

"* * * There seems to be no good reason why persons in possession of the assets of the corporation cannot be brought before the court by summary petition, and, if they admit the possession, and show no beneficial claim or title in themselves, be required to surrender such assets to the receiver. *The Company* [the trustee] *claims no ownership in the assets. Its claim is as trustee for others. The main suit is to settle an insolvent corporation, and the rights of all of the beneficiaries in the trust represented by the Company can be fully protected by the court in the case in which the receiver was appointed.* * * * The proceeds of the collection by the receiver of these claims will be held as a separate fund, subject to the same trusts that were impressed on the claims by the contracts under which they were held by the Company. The Company will not only be protected by the order of the court to surrender the assets, but will also be protected by subsequent orders applying the funds arising from the claims in strict conformity to the trusts under which the claims have been held by the Company." [Italics supplied.]

[9] The circumstance pointed out in the text also answers another argument suggested in the Maryland brief (p. 40, n.), that Fidelity's contracts with the state authorities are "contracts in the public authority," which the bankruptcy court may not reject under Sections 116 (1) and 216 (4) of the Bankruptcy Act (11 U. S. C. 516 (1) and 616 (4)). As the Maryland respondent admitted below, these provisions

B. NEITHER THE ELEVENTH NOR THE TENTH AMENDMENTS BAR THESE PROCEEDINGS IN RESPECT OF STATE DEPOSITS

1. The circumstance that the assets held as security in this case are held by state officials does not raise the Eleventh Amendment as a bar to the usual powers of the reorganization court to deal with these assets under the plan and to enjoin their disposition pending the proceedings.

Under the Eleventh Amendment the courts may not entertain a suit against a state; the respondents assert no personal claim to Fidelity's assets deposited with them, but claim rights there-

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were intended to deal with situations such as those involving contracts between a public utility and a state for the delivery of electric power, not situations like the present where the public authority appears as creditor or trustee for creditors. This is shown by the reorganization cases in which securities held by the Reconstruction Finance Corporation have been dealt with under plans of reorganization. See for instance, *Continental Illinois National Bank & Trust Co.* v. *Chicago, Rock Island & Pacific Ry. Co.*, 294 U. S. 648; *In re East Boston Coal Co.*, 30 F. Supp. 811 (M. D. Pa.).

Even if these provisions were applicable, this proceeding will involve no disaffirmance or rejection of the alleged contract with the Maryland Commissioner. Since the bankruptcy court undoubtedly has power to modify the claims of contract holders, and since, concededly, the Maryland Commissioner holds only for the benefit of contract holders, the bankruptcy court under the plan can satisfy the claims for whose satisfaction the Maryland Commissioner allegedly holds the securities. Surrender of the deposit to the court which can adjust rights in the underlying claims can in no event be considered a violation of the conditions of the alleged contract.

to only as agents of the States. But these factors do not bring the case under the Eleventh Amendment. This Court has uniformly recognized that when an individual is sued for the recovery of property and his jurisdiction for its retention rests on a claim asserted under state authority, he may not cut the suit short *in limine* by claiming immunity under the Eleventh Amendment; the suit may be maintained against his as an individual and his asserted claim of right under authority of his principal, the State, must be tried on the merits. Thus, this Court held in *In re Ayers*, 123 U. S. 443, 501, quoting from *Poindexter* v. *Greenhow*, 114 U. S. 270, 288:

> A defendant sued as a wrong-doer, who seeks to substitute the State in his place, or to justify by the authority of the State, or to defend on the ground that the State has adopted his act and exonerated him, cannot rest on the bare assertion of his defense. He is bound to establish it. * * *

The application of this principle is not limited to situations where the defendant is a "wrong-doer" in the sense that he is a malefactor. The principle is applicable whenever it is claimed that the defendant is acting without authority either because the governmental title upon which he relies is invalid, or because a state statute is unconstitutional, or because—as we shall show is true in this case—the state statute is superseded by paramount federal legislation.

The leading case is *United States* v. *Lee*, 106 U. S. 196.[1] Suit was begun in a Virginia state court against defendants Kaufman and Strong to recover possession of land used as part of Arlington National Cemetery. The case was removed to the federal court. The United States moved to dismiss the proceedings for lack of jurisdiction on the ground that the defendants held only as agents and officers of the United States. A demurrer to the motion was sustained and Kaufman and Stron appealed. This Court held that the defendants' assertion of a claim as agents of the United States entitled them to no immunity from suit. It declared:

> This examination of the cases in this court establishes clearly this result: that the proposition that when an individual is sued in regard to property which he holds as officer or agent of the United States, his possession cannot be disturbed when that fact is brought to the attention of the court, has been overruled and denied in every case where it has been necessary to decide it, and that in many others where the record shows that the case as tried below actually and clearly presented that defence, it was neither urged by counsel nor considered by the court here * * *" (106 U. S. at 215–216).

[1] That case involved an attempt to defeat a suit by pleading the immunity of the *United States* from suit, but the principle applies as well to claims based on the immunity of *states* under the Eleventh Amendment. *Tindal* v. *Wesley*, 167 U. S. 204, *infra*, p. 18.

Significantly, the Court quoted with approval *Davis* v. *Gray*, 16 Wall. 203, as follows:

> Making a State officer a party does not make the State a party, *although her law may have prompted his action, and the State may stand behind him as a real party in interest* (106 U. S. at 215). [Italics by the Court.]

*United States* v. *Lee* has never been questioned.* On nearly identical facts, but where the title asserted was on behalf of a state and the contention was under the Eleventh Amendment, the *Lee* case was followed in *Tindal* v. *Wesley*, 167 U. S. 204, 221, and it was stated that the "settled doctrine" of this Court rejects the argument that a suit to recover possession of property "is a suit against the State simply because the defendant holding possession happens to be an officer of the State and asserts that he is lawfully in possession on its behalf." See also *Ickes* v. *Fox*, 300 U. S. 82, 96; *In re Tyler*, 149 U. S. 164; *Cunningham* v. *Macon & Brunswick Railroad Co.*, 109 U. S. 446; *Poindexter* v. *Greenhow*, 114 U. S. 270; *Ex parte Young*, 209 U. S. 123; *Correa* v. *Barbour*, 71 F. (2d) 9 (C. C. A. 1); *Uebersee Finanz-Korporation Aktien Gesellschaft* v. *Rosen*, 83 F. (2d) 225 (C. C. A. 2).

In the instant case appellants hold property which is asserted to belong to the Debtor, and to which the trustee in bankruptcy of the Debtor

* No case can be cited to undermine the authority of *United States* v. *Lee* and *Tindal* v. *Wesley*. There are, of course,

claims the right of possession. They are sued as individuals in possession of this property. To justify their retention of this property as against the Debtor's trustee, they rely upon authority conferred by the state in exactly the same manner as did the officers of the United States in the *Lee* case and of South Carolina in the *Wesley* case. Unless that authority does in fact justify their conduct, respondents may not withhold the Debtor's property from the Debtor's trustee.

We submit that the state authority cannot justify respondents in withholding the property from the Debtor's trustee. The paramount jurisdiction of the bankruptcy court overrides the state statutes insofar as those statutes purport to permit state officers to retain the deposits and administer the assets, just as the bankruptcy power overrides the

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cases where the bar of the Eleventh Amendment was held to operate, but all of those which even remotely resemble the present case are cases in which the purpose of the suit was to compel compliance by the state with its own contract. Thus, in *Hagood* v. *Southern*, 117 U. S. 52, and *In re Ayers*, 123 U. S. 443, the suits sought to compel the states to accept their bond interest coupons in payment of taxes, as the states had agreed to do. So in *Cunningham* v. *Macon & Brunswick Railroad Co.*, 109 U. S. 446, the suit was to foreclose a mortgage on property owned by the state and the state was personally liable on its guarantee of the bonds secured by the mortgage. In *Lankford* v. *Platte Iron Works*, 235 U. S. 461, and *Farish* v. *State Banking Board*, 235 U. S. 498, the state had guaranteed bank deposits, just as the Federal Deposit Insurance Corporation does now; and the fund, like F. D. I. C. assessments, was designed to discharge the state's direct liability.

powers of receivers under foreclosure practice and equity practice and the powers of trustees in possession under mortgage indentures. *Cf. Chicago Title & Trust Co.* v. *4136 Wilcox Bldg. Corp.*, 302 U. S. 120; *International Shoe Company* v. *Pinkus*, 278 U. S. 261; *Stellwagen* v. *Clum*, 245 U. S. 605; *Globe Bank* v. *Martin*, 236 U. S. 288; *Tua* v. *Carriere et al.*, 117 U. S. 201; *In re Klein*, 1 How. at 277; *Ogden* v. *Saunders*, 12 Wheat. 212; *Hammond* v. *Lyon Realty Company*, 59 F. (2d) 592 (C. C. A. 4); *In re Bankshares Corporation of The United States*, 50 F. (2d) 94 (C. C. A. 2); *Albert Pick & Company* v. *Wilson*, 19 F. (2d) 18 (C. C. A. 8).

In closely related situations the lower federal courts have so held. *In re Bajardi*, 8 F. (2d) 551 (S. D. N. Y.) involved the bankruptcy of certain private bankers. Pursuant to the Banking Law of New York they had deposited with the Superintendent of Banks an amount equal to 10% of their total deposits, subject to sale and disposition of the holdings by the Superintendent on order of a court of competent jurisdiction. The district court held that the Superintendent was required to deliver the assets to the bankruptcy trustee. It said:

> Jurisdiction of the United States court to adjudge private bankers bankrupt and to administer their estates in bankruptcy is not only paramount, but is exclusive, and state laws assuming to confer upon state

> officers or courts authority to administer such bankrupt estates are superseded, and must give way when the Bankruptcy Act is properly invoked. * * *

The decision of the District Court was affirmed in *In re Bajardi*, 9 F. (2d) 797 (C. C. A. 2). The contention was there made that the court below:

> erred in interfering with and assuming jurisdiction over the sovereign right of administration of the said securities imposed by law upon the state of New York through its proper administrative officer (p. 798).

The circuit court of appeals rejected this argument, but ultimately placed its holding on the ground that the state statute was not intended to conflict with the Bankruptcy Act (p. 799):

> It would require very strong language to compel belief that the state Legislature intended to invite conflict with the constitutional prerogative of the United States in respect of bankruptcies, and to inflict upon the creditors of an insolvent, or any class of them, the useless expenses of a double administration. * * *

Accordingly, the Superintendent of Banks was directed to surrender the deposit to the bankruptcy trustee. To the same effect is *In re Faour*, 72 F. (2d) 719 (C. C. A. 2).

The statutes here involved do not evidence any clearer intent to conflict with the bankruptcy

power than did the statute considered in the *Bajardi* case. Therefore, the claims asserted by respondents are not justified by the statutes relied upon when properly construed; but if the statutes be deemed to justify respondents' position, the statutes are superseded by the Bankruptcy Act. On the ground that the state statute had been superseded, it was held in *Gamble* v. *Daniel*, 39 F. (2d) 447 (C. C. A. 8) that the Department of Commerce of Nebraska was required to surrender to the bankrutcy court assets of an insolvent trust company which the Department had taken for liquidation.

Similarly pertinent is *In re Coney Island Hotel Corp.*, 9 F. Supp. 329 (E. D. N. Y.). In that case the owner of a hotel (mortgagor under a bond and mortgage) filed a petition under Section 77B of the Bankruptcy Act and moved that the Superintendent of Insurance of New York be restrained from proceeding under the New York Schackno Act to recognize the same bond issue. The Superintendent argued that the court could not enjoin him from performing his duties under valid New York statutes and that the Eleventh Amendment prohibited suits against the state and state officials. The court answered these contentions as follows (p. 331):

> * * * the argument advanced ignores the provisions of article 1, § 8, of the Constitution, which empowers Congress to establish uniform laws on the subject of

bankruptcy throughout the United States. Accordingly, national bankruptcy statutes are paramount to any state statute the effect of which may impair or emasculate them.

Accordingly, as between the Schackno Act and the provisions of section 77B of the Bankruptcy Act, no construction of any powers vested in the state superintendent of insurance by the Schackno Act can impair the congressional mandate. Such duties or privileges pursuant to which the superintendent of insurance acts cannot vitiate the constitutional authority vested in Congress. *Stellwagen* v. *Clum*, 245 U. S. 605, 38 S. Ct. 215, 62 L. Ed. 507.*

See also *In re Manbeach Realty Corp.*, 10 F. Supp. 523 (E. D. N. Y.).

We submit, therefore, that on the merits the appellants have no right by virtue of the state law to retain the assets as against the trustee in bankruptcy.

2. For the same reason that the Eleventh Amendment does not bar exercise of bankruptcy jurisdiction over the deposited assets, the Tenth Amendment does not bar such exercise. Since there is a valid exercise of bankruptcy jurisdiction to adjust the rights of security holders, the Tenth Amendment does not operate to preserve the remedies provided by the states for such protection.

* Reversed on other grounds in 76 F. (2d) 126 (C. C. A. 2). The circuit court of appeals expressly refrained from discussing the questions on which the district court decision is cited in the text.

Through 140 years of history, this Court never wavered from its repeated assertion that:

> if the act is within the power confined to Congress, the Tenth Amendment, by its very terms, has no application * * *[10]

For a short period during 1935 and 1936 decisions of this Court took a contrary approach. Its interpretations of the Tenth Amendment in the cases cited cannot, we believe, be reconciled with more recent cases. See *Hopkins Federal Savings & Loan Association* v. *Cleary*, 296 U. S. 315; *United States* v. *Butler*, 297 U. S. 1; *Ashton* v. *Cameron County Water Improvement District*, 298 U. S. 513. Two years after the *Ashton* case, which involved the bankruptcy power, the Court held in *Wright* v. *Union Central Ins. Co.*, 304 U. S. 502, 516:

> In view of our decision that the law is within the bankruptcy power, scant reliance can be placed on the Tenth Amendment. * * *

See *United States* v. *Darby*, 312 U. S. 100, 123–124; Feller "The Tenth Amendment Retires," 27 A. B. A. J. 223 (1941).[11]

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[10] *Everard's Breweries* v. *Day*, 265 U. S. 545, 558. See *Gordon* v. *United States*, 117 U. S. 697, 705; *Champion* v. *Ames*, 188 U. S. 321, 357; *Northern Securities Co.* v. *United States*, 193 U. S. 197; *Hoke* v. *United States*, 227 U. S. 308, 320; *Missouri* v. *Holland*, 252 U. S. 416, 432; *United States* v. *Sprague*, 282 U. S. 716, 733.

[11] There is no substance to the contention (West Virginia brief, pp. 35–40) that the legislative history of Section 67 (f) of the Bankruptcy Act (amended by Section 29 of

CONCLUSION

For the foregoing reasons, the property deposited with the states remained property of Fidelity and is subject to reorganization in the district court.

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the Investment Company Act of 1940) evidences an intention that the deposits in the hands of State officials be not disturbed. The argument seems to be that since Section 67 (f) expressly requires state deposits to be turned over to the trustee only with respect to securities sold after January 1, 1941, Congress must have intended that securities sold before that date would not be turned over to the trustee. This argument misconceives the nature of the change made by Section 67 (f). As the legislative history set out in the West Virginia brief makes clear, the purpose of the amended Section 67 (f) was to set up the following scheme with respect to deposits on contracts sold after January 1, 1941:

(1) The bankruptcy trustee is to administer the assets deposited with the state depositaries;

(2) The preference created by the deposit in favor of local security holders is to be determined and recognized;

(3) The security holders entitled to the preference are not to share in the general estate until all other creditors have received from the estate the same percentages of their claims as that which the secured creditors receive under the State deposit.

The change which occurred was in the third feature of this scheme. Prior to that time, persons secured by the state deposits would have been entitled to realize on their security and to prove a general claim for the deficiency under Section 57 (h) of the Bankruptcy Act. The deficiency claim would participate as a general claim on the same basis as the claims of other security holders who had larger deficiencies or who had no security at all. For instance, if the deposit in a particular state were equal to 80% of the claims of local creditors, the contract holders would realize 80% of their

Respectfully submitted.

CHARLES FAHY,
*Solicitor General.*

RICHARD S. SALANT,
*Attorney.*

JOHN F. DAVIS,
*Solicitor,*

HOMER KRIPKE,
*Assistant Solicitor,*

JUSTIN N. REINHARDT,
*Attorneys for the Securities and Exchange Commission.*

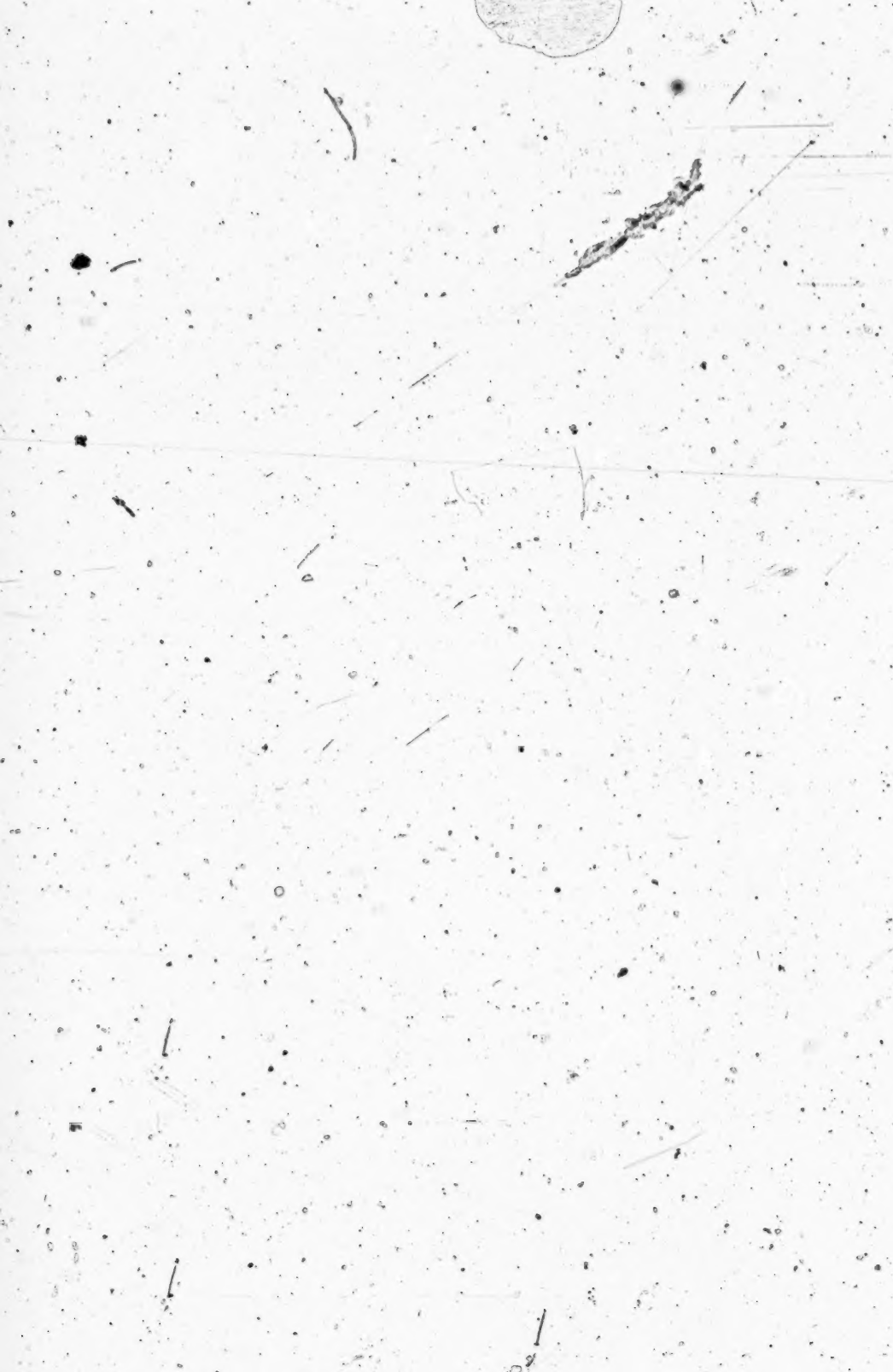
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claims out of the security and would have a 20% claim for the deficiency against the general estate. The 20% deficiency claim would be entitled to share ratably with the 100% general claims of contract holders who were not secured by any deposit.

The purpose of the amendment to Section 67 (f) was to prevent the inequality indicated by the foregoing illustration. The legislative history evidences no Congressional belief that prior to the passage of Section 67 (f), the first two elements of the scheme mentioned did not already exist. There is nothing in the legislative history to show that Congress thought that without the change the bankruptcy court would have no power to take possession from the state officials and to administer the deposited assets while adjudicating and recognizing the rights created under the state deposits. We have shown that that power exists.

U. S. GOVERNMENT PRINTING OFFICE: 1943



Office - Supreme Court, U. S.
FILED
JAN 25 1943
CHARLES ELMORE CROPLEY
CLERK

# IN THE
# SUPREME COURT OF THE UNITED STATES

**OCTOBER TERM, 1942**

**NO. 319**

FIDELITY ASSURANCE ASSOCIATION, A Corporation, Debtor, and CENTRAL TRUST COMPANY, Trustee for Fidelity Assurance Association,

*Petitioners,*

vs.

EDGAR B. SIMS, Auditor of the State of West Virginia, and Ex Officio Insurance Commissioner of the State of West Virginia; ROSS B. THOMAS and H. ISAIAH SMITH, West Virginia State Court Receivers, et al.,

*Respondents.*

## JOINT AMICI CURIAE BRIEF

GEORGE F. BARRETT, Attorney General, State of Illinois, Springfield, Illinois; CLAIR JOHN KILLORAN, Attorney General, State of Deleware, By THOMAS HERLIHY, JR., Deputy Attorney General, Wilmington, Delaware; GERALD C. MANN, Attorney General of Texas, Austin, Texas; WALTER R. JOHNSON, Attorney General of Nebraska, Lincoln, Nebraska; EUGENE STANLEY, Attorney General of Louisiana, Baton Rouge, Louisiana; I. H. VAN WINKLE, Attorney General of Oregon, Salem, Oregon; HUBERT MEREDITH, Attorney General of Kentucky, Frankfort, Kentucky; ROBERT W. KENNEY, Attorney General of California, by NEIL CUNNINGHAM, Assistant, San Francisco, California; ROBERT B. HARWOOD, Attorney General of Alabama, by BOWEN W. SIMMONS, Assistant, Montgomery, Alabama; ~~JOHN F. X. McGOHEY, Department of Law, State Office Building, 80 Center Street, New York, New York~~; A. B. MITCHELL, Attorney General of Kansas, Topeka, Kansas; THOMAS J. HERBERT, Attorney General of Ohio, by DALE DUNIFON, First Assistant, Columbus, Ohio; SMITH TROY, Attorney General, State of Washington, Olympia, Washington; ALVIN C. STRUTZ, Attorney General, State of North Dakota, Bismarck, North Dakota; GROVER A. GILES, Attorney General of Utah, Salt Lake City, Utah; GEORGE N. BEAMER, Attorney General of Indiana, Indianapolis, Indiana; ALEX W. NEAL, JR., Receiver of Fidelity Assurance Association, Richmond, Virginia.

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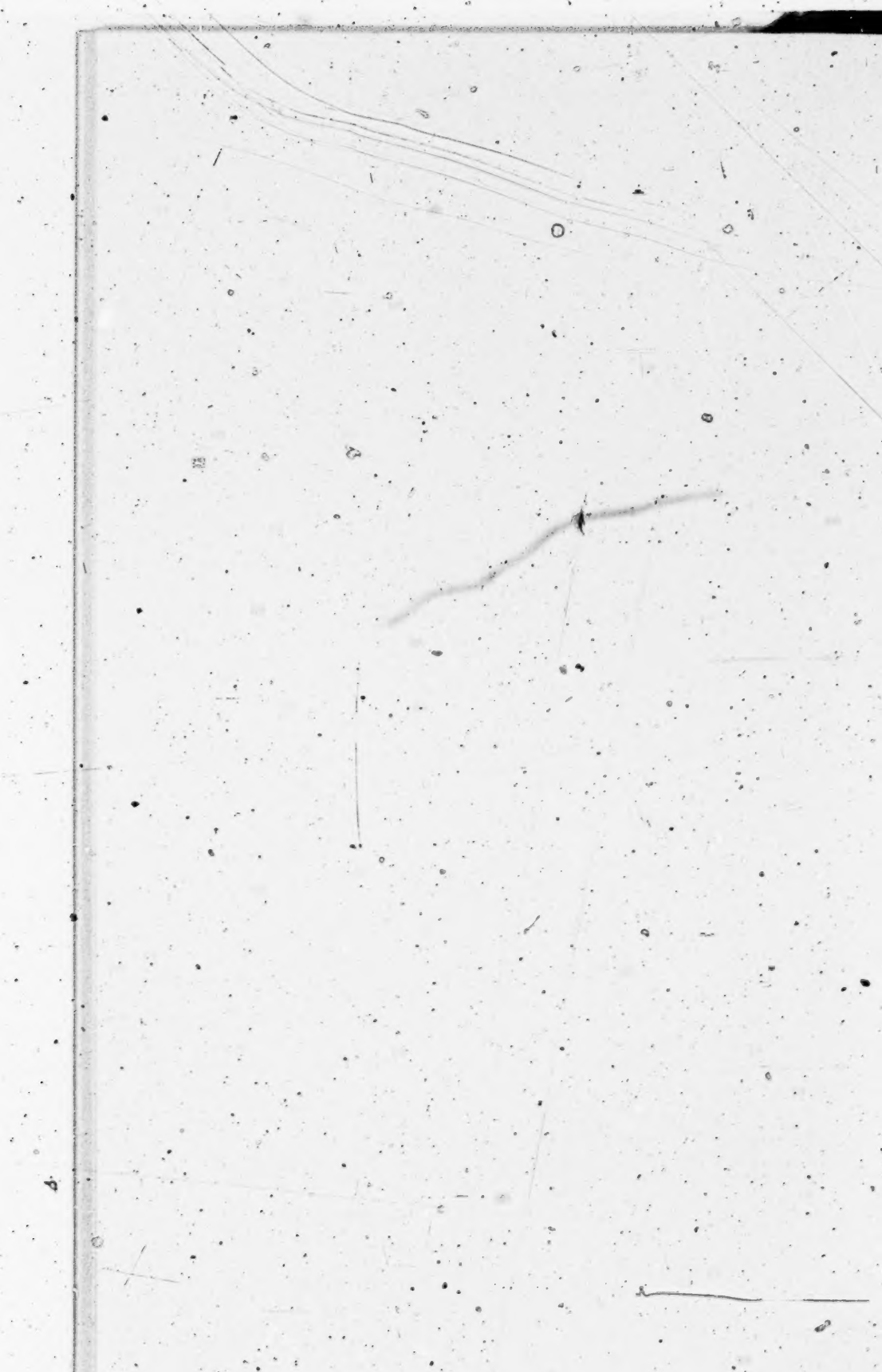
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*Respondents.*

## JOINT AMICI CURIAE BRIEF ON BEHALF OF THE STATES AND STATE OFFICIALS OF ILLINOIS, ALABAMA, DELAWARE, KANSAS, KENTUCKY, INDIANA, OHIO, NEW YORK, TEXAS, NORTH DAKOTA, CALIFORNIA, LOUISIANA, NEBRASKA, OREGON, WASHINGTON, UTAH, AND THE STATE COURT RECEIVER OF VIRGINIA.

## STATE OF THE CASE.

The opinions below, jurisdiction, and statutes involved, are fully set forth in the briefs of the parties to the case.

Fidelity Assurance Association, formerly Fidelity Investment Association, a West Virginia corporation, was licensed to do business in the States of Alabama, Delaware, Kansas, Kentucky, Illinois, Indiana, Ohio, and Virginia, as well as other States in the United States. Each of the above named States, by their laws, required

that Fidelity make a deposit in that State as a prerequisite to obtaining a license to do business therein, such deposit to be for the benefit of, and the protection of, the contract holders in each such State. Such deposits were made as required by law. In some of these States the deposit was required by the State authorities to be in the form of a trust indenture, with the deposit to be made with a named trustee in the State, usually a bank, and the contract purchasers were the named beneficiaries. In the other States the deposit was made directly with State officials, and is at present held by them as trustees for the benefit of their residents, as required by statute.

As shown by the evidence, the list given below, in Exhibit A attached hereto and made a part hereof, gives the number of contract holders in each of these States, the amount of the deposit made by Fidelity in each of these States and now held therein and the net cash and net reserve liability to contract holders. These States are not respondents in the instant proceedings, but are vitally interested therein, as the sovereign rights of their States and the financial rights and interests of their citizens are directly involved, and they will be bound by the decision of this Court in this case.

The States of California, Louisiana, Nebraska, New York, North Dakota, Oregon, Texas, Washington, and

Utah are not respondents in the case, do not have a deposit of Fidelity, but, as shown in Exhibited B attached hereto and made a part hereof, a number of their residents and citizens in each of those States hold a Fidelity contract with the net cash liability to the contract holders shown.

Each of these last mentioned States has depository laws requiring companies such as was Fidelity, insurance companies, and other foreign corporations of a similar nature, to make a deposit in their State as a prerequisite to obtaining a license to do business therein, for the benefit and protection of their contract holders. Each of said States at the present time has a very substantial deposit from another company which did and does a business very similar to that in which Fidelity was engaged. The deposits of such company are held as a trust fund for the benefit of the contract holders in each of these States.

## ARGUMENT.

Each of the above States holding a deposit of Fidelity desires to liquidate that deposit and distribute the proceeds thereof to the contract holders of their respective States lawfully entitled thereto, as determined by an interpretation of the depository laws of their States, by their own respective State Courts in proceedings instituted in compliance with the laws of their respective States.

The said depository States understand that if their deposit is insufficient to pay their contract holders 100%, there are assets on deposit in West Virginia to which their contract holders may look for further reimbursement.

The above named States who do not hold a deposit of Fidelity are advised that the State of West Virginia, under its laws, required a deposit to be made therein for the protection of the contract holders in their States wherein no deposit was required of Fidelity, and are further advised that the contract holders of their States have received proofs of claim from the officials in West Virginia, and that their contract holders have filed their proofs of claim against that fund.

None of the States joining this brief *amici curiae* have made any protest or objection to the actions and proceedings taken by the Attorney General and officials of the State of West Virginia, and these States are willing and satisfied that the proper officials of the State of West Virginia shall proceed in their proper State Court, as they understand is being done, to liquidate the securities held on deposit in West Virginia, and to distribute the proceeds thereof to those judically found rightfully entitled thereto. These States appearing *amicus curiae* respect and believe in the honesty and integrity of the State Courts of West Virginia, the officials thereof, the Attorney General of West Virginia, and the duly elected officers of the State of West Virginia, and have no reason to doubt but that they will carry out their required duties in the premises fairly and ably and without partiality or prejudice, to the best of their abilities, as required by the laws of their State and by the decisions of their State Courts.

These States appearing *amicus curiae* further believe in the honesty and integrity of the Courts, Attorney Generals, and officials of the other States who are respondents in the case at bar, and are fully confident that they also will faithfully and ably and without partiality or prejudice carry out their respective required duties,

and that the officials of all of these States will cooperate to mutually work out their interrelated problems.

**Specific Reasons for the Filing of this Brief.**

Each of the States who are parties to this brief have depository laws applicable to foreign corporations coming into the State to do business, have deposits from many foreign corporations doing various types of business, and are retaining those deposits as trust funds for the protection of the citizens of their States as provided by their respective State laws and the decisions of their State courts thereon.

The Attorney Generals of the respective States who are filing this amici curiae brief understand that the case at bar will determine, among other questions, the question of whether such deposits made in compliance with valid State laws and put in the custody and possession of State officials under those laws can or should be taken from the possession and custody of those officials in the event of insolvency of the depositing company, and be required to be turned over for liquidation to a federal trustee appointed in Chapter X proceedings in bankruptcy; whether the trust lien created by statute or trust indenture in favor of the citizens or residents of such State who have dealt with such corporation can or should be nullified or avoided; whether the depository laws of

each of these respective States, in the event of insolvency, should be interpreted by the State Courts of the State which enacted those laws, or by the Federal Courts sitting in bankruptcy in a foreign jurisdiction in Chapter X proceedings.

These respective Attorney Generals are not unmindful of the fact that in the future Congress may see fit or deem it necessary to include insurance companies within the purview of the Bankruptcy Act, in which event the deposits made in each of these respective States, as well as other States of the Union, would be vitally affected by a determination of these questions in the case at bar.

It is the further understanding of those appearing here now as amici curiae that the respondents in the above case, except the Securities and Exchange Commission, adopt and support by their briefs the position that deposits made with States under valid State laws should, in the event of insolvency, remain in the custody and possession of those State officials and be administered and liquidated by them in the State Courts provided by law therefor; that the trust or other liens in favor of the citizens and residents of those States wherein the deposit is made for their benefit cannot and should not be avoided, set aside, or nullified; that interpretations of the depository laws as to which of the respective citizens

and residents of each of the respective States should participate in the deposited assets, are questions of State law; and that those and all other interpretations of the depository laws of each of the States must and should be determined by the respective State Courts wherein such legislation was enacted.

As a determination of these questions and the result of this litigation will involve the sovereign rights of the several States appearing amici curiae herein, to require, under their police powers, deposits to be made by foreign corporations coming into the State, for the protection of domestic residents who may do business with such corporations; and will involve the sovereign rights of these States to administer such deposits in the event of insolvency as a part of the internal administration of their State laws; and will involve their sovereign right to have their own State statutes interpreted solely by their own tribunals; and will vitally affect the financial interests of their citizens, therefore these amici curiae States, through their Attorney Generals, adopt and support the above contentions and positions of the respondents in the case at bar, with the exception of the respondent, the Securities and Exchange Commission, and respectfully urge this Court to affirm and sustain the judgment entered below by the United States Circuit Court of Appeals for the Fourth Circuit in these respects.

These States appearing amici curiae particularly urge this Court to uphold and sustain the following propositions, which are more fully set forth and agrued in the brief of the several respondents:

1. That Congress in enacting Chapter X of the Bankruptcy Act did not intend that companies doing the kind of business in which Fidelity was engaged were precluded from being liquidated in State Courts under the laws of the respective States;

2. That required deposits of foreign corporations coming into the several States to do business shall not, in the event of insolvency, be taken from the custody, possession, control and administration of the officials of the States with whom such deposits were required to be made;

3. That such required deposits made in accordance with valid State laws for the benefit of the security purchasers and holders in each of the several States are impressed with a trust lien under the several State laws in favor of the security owners and holders, which under no circumstances can be set aside, nullified or avoided;

4. An interpretation of the depository laws of the several States should be made only in the State Courts of the particular States which enacted that legislation, rather than in a Federal Court sitting in bankruptcy;

5. That in the instant case the deposits made with the several States should be liquidated as expeditiously as possible, yet in an orderly manner, so as to obtain the greatest amount possible for the said securities, and distribution of the proceeds thereof should be made promptly following a determination by the Courts of the several States as to those properly entitled thereto under decisions and interpretations of the respective State laws by those State Courts.

## CONCLUSION.

In view of the importance of the decision in this case to the several States of the United States, it is respectfully urged that whatever decision may be made by the Court in the particular circumstances, that it affirm the decision of the Circuit Court of Appeals and the position of the respondents in the particulars set out. An adverse decision to the position herein taken would not only vitally adversely affect the interests of the thousands of persons, residents and citizens of these States, who are personally and financially interested in Fidelity, but would do irreparable harm and injury to these *amici curiae* States, their State laws, and the millions of their citizens who look to these and similar State deposits for the protection of their interests in the many types of financial corporations required to make such deposits.

Respectfully submitted,

GEORGE F. BARRETT,
Attorney General,
State of Illinois,
Springfield, Illinois.

GERALD C. MANN,
Attorney General of Texas,
Austin, Texas.

EUGENE STANLEY,
Attorney General of Louisiana,
Baton Rouge, Louisiana.

HUBERT MEREDITH,
Attorney General of Kentucky,
Frankfort, Kentucky.

CLAIR JOHN KILLORAN,
Attorney General,
State of Delaware,

By, THOMAS HERLIHY, JR.,
Deputy Attorney General,
Wilmington, Delaware.

WALTER R. JOHNSON,
Attorney General of Nebraska,
Lincoln, Nebraska.

I. H. VAN WINKLE,
Attorney General of Oregon,
Salem, Oregon.

ROBERT W. KENNEY,
Attorney General of California,
By, NEIL CUNNINGHAM, Assistant,
San Francisco, California.

ROBERT B. HARWOOD,
Attorney General of Alabama,
By, BOWEN W. SIMMONS, Assistant,
Montgomery, Alabama.

A. B. MITCHELL,
Attorney General of Kansas,
Topeka, Kansas.

SMITH TROY,
Attorney General,
State of Washington,
Olympia, Washington.

GROVER A. GILES,
Attorney General of Utah,
Salt Lake City, Utah.

ALEX W. NEAL, JR.,
Receiver of Fidelity Assurance
Association,
Richmond, Virginia.

JOHN F. X. MCGOHEY,
Department of Law,
State Office Building,
80 Center Street,
New York, New York.

THOMAS J. HERBERT,
Attorney General of Ohio,
By, DALE DUNIFON, First Assistant,
Columbus, Ohio.

ALVIN C. STRUTZ,
Attorney General,
State of North Dakota,
Bismarck, North Dakota.

GEORGE N. BEAMER,
Attorney General of Iniana,
Indianapolis, Indiana.

## EXHIBIT A.

**Contracts, Liabilities and Deposits of Fidelity Assurance Association with States Filing Brief Amicus Curiae, which Required Deposits from Fidelity.**

| | Total Number of Contracts | Net Cash Liability Apr. 10, 1941 | Securities Deposited Market Value June 6, 1941 | Percentage of Market Value to Cash Liability |
|---|---|---|---|---|
| Alabama | 172 | $ 31,346.71 | $ 32,555.16 | 103 |
| Delaware | 875 | 290,175.36 | 293,790.63 | 101 |
| Illinois | 12,209 | 4,225,790.75 | 3,759,894.00 | 89 |
| Indiana | 1,293 | 386,173.45 | 162,863.44 | 42 |
| Kansas | 405 | 108,784.89 | 85,337.50 | 76 |
| Kentucky | 662 | 92,690.42 | 86,712.50 | 93 |
| Ohio | 14,807 | 2,360,418.70 | 509,573.44 | 21 |
| Virginia | 2,443 | 557,809.12 | 27,703.13 | 5 |

## EXHIBIT B.

**Contracts and Liabilities of Fidelity Assurance Association in States Appearing Amici Curiae who have no Deposit of Fidelity.**

| State | Total Number of Contracts | Net Reserve Liability April 10, 1941 | Net Cash Liability April 10, 1941 |
|---|---|---|---|
| California | 236 | $174,940.15 | $169,577.35 |
| Louisiana | 375 | 42,934.29 | 40,941.77 |
| Nebraska | 20 | 7,882.08 | 7,661.27 |
| New York | 1,456 | 690,448.27 | 669,824.67 |
| North Dakota | 10 | 37,394.11 | 36,487.35 |
| Oregon | 11 | 4,323.01 | 4,137.24 |
| Texas | 84 | 39,152.19 | 37,829.08 |
| Washington | 41 | 35,646.49 | 34,650.60 |
| Utah | 3 | 2,020.48 | 1,944.00 |

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CHARLES ELMORE CROPLEY
CLERK

IN THE

# SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1942

NO. 319

FIDELITY ASSURANCE ASSOCIATION, A Corporation, Debtor, and CENTRAL TRUST COMPANY, Trustee for Fidelity Assurance Association,

*Petitioners,*

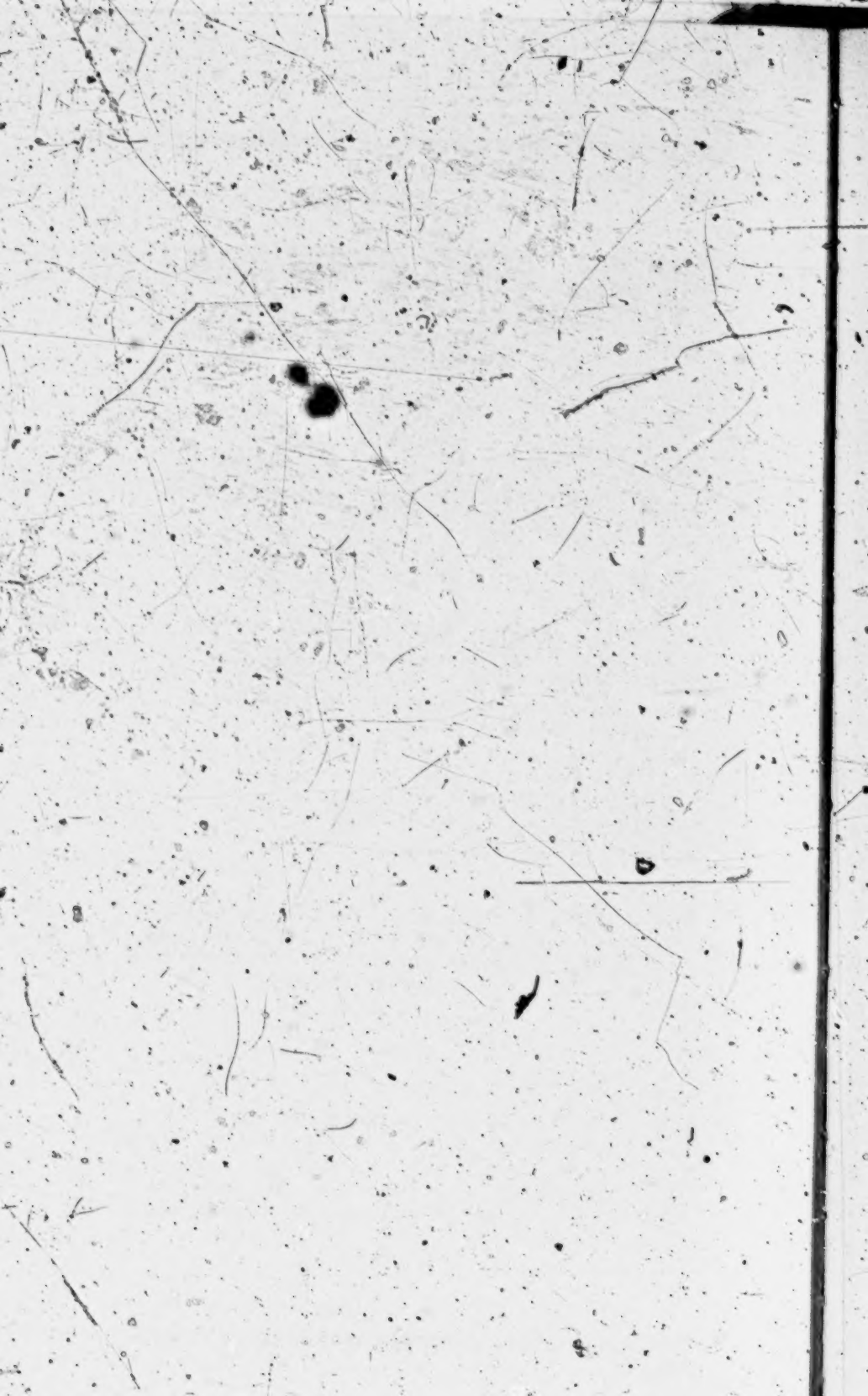
vs.

EDGAR B. SIMS, Auditor of the State of West Virginia, and Ex Officio Insurance Commissioner of the State of West Virginia; ROSS B. THOMAS and H. ISAIAH SMITH, West Virginia State Court Receivers; BANKING COMMISSION OF WISCONSIN; CHAS. R. FISCHER, Commissioner of Insurance and Permanent Receiver for Debtor Corporation In and For The State of Iowa; JOHN B. GONTRUM, Insurance Commissioner of the State of Maryland; DEWEY S. GODFREY, Missouri State Court Receiver; L. H. BROOKS, Trustee, FREDERICK LEAKE and A. L. GOLDBERG, JR., Trustee; and SECURITIES AND EXCHANGE COMMISSION,

*Respondents.*

## STATEMENT AMICUS CURIAE IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT

GEORGE F. BARRETT,
*Attorney General of the State of Illinois,*
GEORGE N. BEAMER,
*Attorney General of the State of Indiana,*
THOMAS J. HERBERT,
*Attorney General of the State of Ohio,*
J. W. JONES,
*Asst. Attorney General of the State of Kentucky.*



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# IN THE

# SUPREME COURT OF THE UNITED STATES

**OCTOBER TERM, 1942**

**NO. 319**

FIDELITY ASSURANCE ASSOCIATION, A Corporation, Debtor, and CENTRAL TRUST COMPANY, Trustee for Fidelity Assurance Association,

*Petitioners,*

vs.

EDGAR B. SIMS, Auditor of the State of West Virginia, and Ex Officio Insurance Commissioner of the State of West Virginia; ROSS B. THOMAS and H. ISAIAH SMITH, West Virginia State Court Receivers; BANKING COMMISSION OF WISCONSIN; CHAS. R. FISCHER, Commissioner of Insurance and Permanent Receiver for Debtor Corporation In and For The State of Iowa; JOHN B. GONTRUM, Insurance Commissioner of the State of Maryland. DEWEY S. GODFREY, Missouri State Court Receiver; L. H. BROOKS, Trustee, FREDERICK LEAKE and A. L. GOLDBERG, JR., Trustee; and SECURITIES AND EXCHANGE COMMISSION,

*Respondents.*

## STATEMENT AMICUS CURIAE IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT.

*To the Honorable the Chief Justice and the Associate Justices of the Supreme Court of the United States:*

The undersigned representatives of the Legal Departments of their respective States are not parties to the appeal to the Circuit Court of Appeals in this case but, having a profound interest in the subject matter

thereof, we offer as amicus curiae these suggestions in opposition to the petition for certiorari.

Now come the undersigned and offer opposition to the petition of the Fidelity Assurance Association and Central Trust Company, who did petition this Court for the issuance of a writ of certiorari to the United States Circuit Court of Appeals of the Fourth Circuit to review a decision of that Court heretofore entered on the 16th day of June, 1942, and in which rehearing has been denied by that Court.

The opinion of the Circuit Court of Appeals sought to be reviewed by the petition herein reversed an order of the District Court for the Southern District of West Virginia, entered January 5, 1942, sustaining the petition for reorganization of the Fidelity Assurance Association under Chapter X of the Bankruptcy Act. The order of the District Court held that:

A. The Fidelity was not an insurance company as contemplated by the Bankruptcy Act. (Trans. p. 19).

B. The petition for reorganization was filed in good faith as required by the act. (Trans. p. 34).

And thereupon the trial court by its decree dismissed all petitions and opposition pleadings thereto and directed that securities held by other states be turned over

at once to its appointed trustee, and, summarily ordered each state officer having any such securities to immediately comply therewith.

The finding that the Fidelity was not an insurance company was made by the trial court before the record disclosed the abundant evidence which was later discovered by creditors. (Transcript of Record 339 and following). And it was stipulated by the Fidelity that its "*total number of Series B Contracts with insurance clause on December 31st, 1940, was 14,626.*" Trans. pp. 361, 362).

On the question of good faith the trial court reached the conclusion that the petition complied with the degree of good faith required by the Bankruptcy Act. Yet the District Judge in his opinion disclosed his grave doubt as to the good faith of the petition as well as his belief that nothing could be reasonably expected of the Fidelity but a so-called slow liquidation. Some of the expressions of the trial Judge which support the above statement are as follows:

> "It is extremely doubtful whether, in view of unsettled economic conditions and the critical international situation, the Fidelity plan would any longer appeal to a large public; but it is not impossible; and it is not the duty of the court to decide for the public that investors will not or should not buy these contracts in the future." (Trans. p. 28).

"It is not necessary that there be a reasonable prospect for the successful rehabilitation of the Debtor as a going or continuing corporation. It is sufficient if it is shown that the Debtor is in a position to conform to and obtain the benefits of the statute for a slow, beneficial and orderly liquidation." Trans. p. 30).

"The character of Debtor's asets is such that it would be peculiarly beneficial in its case to obtain slow and orderly liquidation, if such should be found to be the only feasible plan." (Trans. p. 31).

The Circuit Court of Appeals, after an examination of the record of the evidence in this case, unanimously found the Fidelity Assurance Association to be an insurance company; also found that the petition for reorganization was not filed in good faith, either in law as prescribed by Chapter X of the Bankruptcy Act, or in fact.

A brief summary of the policy or contract holders in States where securities have been deposited to protect the citizens under the several State statutes in their investments is as follows:

# FIDELITY ASSURANCE ASSOCIATION SUMMARY

## Deposits by States

## as of June 6, 1941

| | No. of Shares | Par Value | Book Value | Market Value |
|---|---|---|---|---|
| Alabama | | 29,500.00 | 30,962.76 | 32,555.16 |
| Delaware | | 330,000.00 | 312,708.91 | 293,790.63 |
| Illinois | | 4,275,000.00 | 3,934,572.87 | 3,759,894.00 |
| Indiana | | 166,000.00 | 159,278.50 | 162,863.44 |
| Iowa | | 42,000.00 | 39,975.90 | 45,082.50 |
| Kansas | | 85,000.00 | 81,019.50 | 83,337.50 |
| Kentucky | | 85,000.00 | 77,219.00 | 86,712.50 |
| Maryland | | 600,000.00 | 571,998.80 | 470,806.25 |
| Missouri | | 1,085,000.00 | 938,400.70 | 861,100.62 |
| Ohio | | 488,000.00 | 487,786.10 | 509,573.44 |
| Pennsylvania | | 211,000.00 | 213,866.96 | 232,591.57 |
| Tennessee | | 195,000.00 | 193,120.62 | 196,574.38 |
| Virginia | | 25,000.00 | 25,505.00 | 27,703.13 |
| West Virginia | 38,914 95/100 | 15,480,053.13 | 14,534,766.87 | 10,674,696.08 |
| Wisconsin | | 2,499,000.00 | 2,532,457.91 | 2,619,399.07 |

## Liabilities by States

## as of April 10, 1941

| | Net Reserve Liability | Net Cash Liability |
|---|---|---|
| Alabama | $ 32,267.31 | $ 31,346.71 |
| Delaware | 300,074.88 | 290,175.36 |
| Illinois | 4,368,348.52 | 4,225,790.75 |
| Indiana | 398,336.17 | 386,173.45 |
| Iowa | 35,332.03 | 34,478.27 |
| Kansas | 111,530.90 | 108,784.89 |
| Kentucky | 95,376.98 | 92,690.42 |
| Maryland | 508,163.70 | 492,552.24 |
| Missouri | 807,263.78 | 786,988.86 |
| Ohio | 2,439,364.17 | 2,360,418.70 |
| Pennsylvania | 4,816,175.07 | 4,668,582.25 |
| Tennessee | 206,879.70 | 200,504.97 |
| Virginia | 572,585.25 | 557,809.19 |
| West Virginia | 7,121,651.33 | 6,896,398.88 |
| Wisconsin | 2,408,301.57 | 2,342,978.73 |

**Deposits by States**

| | | | | |
|---|---|---|---|---|
| Total Deposited ..... | 38,914 95/100 | $25,595,553.13 | $24,133,640.40 | $20,056,680.27 |
| Not Deposited Securities ..... | 190,677 50/100 | 548,264.80 | 1,337,807.97 | 556,467.51 |

**Liabilities by States**

| | | |
|---|---|---|
| Total Deposited | | |
| Not Deposited Securities ..... | $24,221,651.36 | $23,475,668.67 |

**Deposits by States**

| | | | | |
|---|---|---|---|---|
| Total ..... | 229,592 45/100 | 26,143,817.93 | $25,471,448.37 | $20,613,147.78 |

**Liabilities by States**

| | | |
|---|---|---|
| Total ..... | $24,221,651.36 | $23,475,668.67 |

* Net Liability is determined by deducting loans made to Contract-owners.

Many of the other States are filing authorities upon the two principal questions involved in this case, viz.: (a) Was the petition of the Fidelity Assurance Association filed in good faith as defined in Chapter X of the Bankruptcy Act; (b) Is the Fidelity Assurance Association an insurance company as contemplated by the Bankruptcy Act.

We are, therefore, content, in order to avoid copious duplication, to offer brief suggestions to this Court in opposition to the petition in view of the fact that it is our sincere belief that a delay occasioned by a review in this case will not only consume the time of this Court

unnecessarily but must inevitably result in the approval of the opinion of the Circuit Court of Appeals as above stated, as well as considerable loss to both creditors and contract-holders of the Fidelity Assurance Association. Not only will it be detrimental, as above set forth, but will keep out of circulation more than $20,000,000.00 and which should at once be turned back to the many thousand contract-holders.

The statutory laws of the State of Illinois, which give adequate and speedy liquidation of distribution of funds and securities of insolvent insurance companies in Illinois are hereto attached marked Exhibit "A", and made a part of these proceedings.

The State of Illinois has similar laws by which to liquidate and distribute deposited assets in savings companies other than insurance companies.

Similarly the states of Ohio, Indiana and Kentucky have adequate laws for the liquidation and distribution of the funds and securities held for the use and benefit of the contract-holders in the respective States, whether the company be deemed an insurance company or a savings and investment company.

We do not dispute the right of Congress, through its Bankruptcy Act, to confer upon the several Federal District Courts the power of reorganization of corpora-

tions, even though its property may be located in many States and embraced with the license of contract-holders. Such proceedings, under the present statute, contemplate a reorganization desired by the creditors and contract-holders not for the sole benefit of the stockholders. The good faith required of a petition by Chapter X has been defined so many times in the authorities submitted by these proceedings that it is unnecessary to argue further that the debtor's original petition offers no benefit or advantage to its creditors. To this date no person has offered any financial guarantee to further its reorganization, and in the light of the record of facts shown in these proceedings it may be safely suggested that no financial aid or guarantees will ever be offered by anyone as an inducement to the creditors to sanction reorganization. The District Court's decree means nothing more than an indefinite term of liquidation with corresponding delays and losses to the policy or contract-holders. On the other hand, if the Circuit Court of Appeals' opinion shall prevail in this case many millions of dollars will find their way back to the many contract-holders and eventually find their way into the War Treasury. The sentiments of the trial court to save harmless so far as might be possible the home institution are commendable, and it may be said, to the credit of the trial judge, that the company concealed from him the fact of its activities

which classified it as an insurance company, and such facts did not become conclusively shown until a petition to remand was presented to the Circuit Court of Appeals setting forth the discovery of such evidence. (Trans. p. 339) resulting in the sitpulation as shown on transcript 361-362, where it appears that the Company admitted having written more than fourteen thousand policies.

Whether the Fidelity Assurance Association may be said to be an insurance company or some other kind of savings company, the fact remains that the States holding securities for the protection of their citizens in guarantee made to them by the surety company have laws adequate for speedy and prompt liquidation of such securities, which laws the policy or contract-holders relied upon when they joined the contract. There can, therefore, be no point to induce this Court to push aside the State laws of the several States and take away their securities and center the same in a so-called reorganization by liquidation.

We are aware that it is urged that such proceedings cannot come about except with the consent of the creditors. Sufficient answer to that statement is that the very reason Congress provided certain necessary conditions precedent to reorganization proceedings, the most important of them being that a petition should be filed in

good faith, that Congress realized that a debtor must take what he can get; also, that ingennous methods could be speedily manufactured and devised by which creditors may be high-pressured into "consenting" to something called reorganization.

The effect of force as against the State laws for liquidating the securities of insurance companies and other savings corporations deposited under their requirements can only result in hostility on the part of the several States against permitting non-resident corporations to transact business therein, and must eventually germinate into unwise restrictive laws on the part of the several States. The effect of the petition for certiorari, if allowed by this Court, means freezing of great quantities of assets at a time when the same are so badly needed for other purposes and can only operate for the benefit of the stockholders and to the detriment of everybody else.

We therefore respectfully submit that this petition for certiorari should be denied.

GEORGE F. BARRETT,
*Attorney General of the State of Illinois,*
Springfield, Illinois.
GEORGE N. BEAMER,
*Attorney General of the State of Indiana,*
Indianapolis, Indiana.
THOMAS J. HERBERT,
*Attorney General of the State of Ohio,*
Columbus, Ohio.
J. W. JONES,
*Asst. Attorney General of the State of Kentucky.*

## EXHIBIT "A"

## (ILLINOIS INSURANCE CODE)

### Article XIII. Rehabilitation, Liquidation, Conservation and Dissolution of Companies

Sec. 187. Scope of article.] This article shall apply to every company which is doing or attempting to do, or which is representing that it is doing an insurance business in this State or which is in process of organization for the purpose of doing or attempting to do such business.

Sec. 188. Grounds for rehabilitation and liquidation of domestic company.] Whenever any domestic company

(a) is insolvent; or

* * * * * * * * *

(e) is found to be in such condition that its further transaction of business would be hazardous to its policyholders, or to its creditors, or to the public; or

* * * * * * * * *

(j) has commenced, or has attempted to commence, any voluntary liquidation or dissolution proceeding, or any proceeding to procure the appointment of a receiver, liquidator, rehabilitator, sequestrator, or similar officer for itself; or

(k) is a party, either plaintiff or defendant in any proceeding in which an application is made for the appointment of a receiver, custodian, liquidator, rehabilitator, sequestrator or similar officer for such company or its property, or a receiver, custodian, liquidator, rehabilitator, sequestrator or similar officer for such company or its property is appointed by any court, or such appointment is imminent; or

* * * * * * * * * *

(n) * * * * * * * * * *

then the Director shall report any such case to the Attorney General of this State whose duty it shall be to apply forthwith by petition on relation of the Director in the name of the People of the State of Illinois to the Circuit or Superior Court of the county in which the principal office of such company is located for an order directing such company, upon such notice as the Circuit or Superior Court may prescribe, to show cause why an order to rehabilitate or liquidate the company should not be entered as provided in this article, and for such other relief as the nature of the case and the interests of its policyholders, creditors, members, stockholders or the public may require. Such order to show cause and the service thereof as prescribed in this article shall constitute legal process in lieu of any other process otherwise provided by law.

SEC. 189. INJUNCTION.] The court shall have jurisdiction, at any time after the filing of the petition to issue an injunction restraining such company and its officers, agents, directors, employees and all other persons from transacting any company business or disposing of its property until the further order of the court. The court may issue such other injunctions or enter such other orders as may be deemed necessary to prevent interference with the proceedings, or with the Director's possession and control or title, rights or interests as herein provided or to prevent interference with the conduct of the business by the Director, and may issue such other injunctions or enter such other orders as may be deemed necessary to prevent waste of assets or the obtaining of preferences, judgments, attachments or other like liens or the making of any levy against such company or its property and assets while in the possession and control of the Director.

* * * * * * * * *

SEC. 193. DUTIES OF DIRECTOR AS LIQUIDATOR—SALES—NOTICE TO CREDITORS—REINSURANCE.] (1) Upon the entry of an order directing liquidation, the Director shall immediately proceed to liquidate the property, business and affairs of the company. He is hereby authorized to deal with the property and business of the company in

his name as Director, or, if the court shall so order, in the name of the company.

(2) He may, subject to the approval of the court, sell or otherwise dispose of the real and personal property, or any part thereof, and sell or compromise all doubtful or uncollectible debts or claims owing to the company including claims based upon an assessment levied against a member or a subscriber of any company issuing assessable policies.

(3) He shall as soon as may be conveniently possible, give notice to all creditors who may have claims against the company, as revealed by the records of the company, to present the same.

(4) In order to preserve so far as possible the rights and interests of the policyholders of the company whose contracts were cancelled by the liquidation order and of such other creditors as may be possible, the Director may solicit a contract or contracts whereby a solvent company or companies will agree to assume in whole, or in part, or upon a modified basis, the liabilities owing to said former policyholders or creditors. If, after a full hearing upon a petition filed by the Director, the court shall find that the Director endeavored to obtain the best contract for the benefit of said parties in interest, and if the said Director shall report to the court that he is ready

and willing to enter into a contract and submit a copy thereof to the court, the court shall examine the procedure and acts of the Director, and if the court shall find that the best possible contract in the interests of said parties has been obtained and that it is best for the interests of said parties that said contract be entered into, the court shall by written order approve the acts of the Director and authorize him to execute said contract.

* * * * * * * * *

SEC. 197. GROUNDS FOR CONSERVATION OF ASSETS OF FOREIGN OR ALIEN COMPANY.] (1) Whenever any of the grounds for rehabilitation or liquidation of domestic companies specified in clauses (a), (b), (c), (d), (e), (f), (g), (j), (k) and (n) of Section 188, arise or exist with reference to any foreign or alien company authorized to transact the business of insurance in this State and having assets in this State, the Director may proceed for the filing of a petition as provided in this article against domestic companies, for an order directing such foreign or alien company to show cause why the Director should not take possession of its assets in this State and conserve such assets for the benefit of its creditors and for such other relief as the nature of the cause and the interests of its policyholders, creditors, members, stockholders or the public may require.

(2) The court shall have jurisdiction to issue injunctions and to enter such other orders as it may deem necessary as is provided in the case of a petition against a domestic company so far as such injunctions or orders may apply to such foreign or alien company. If the court finds that sufficient cause for conservation exists, it shall direct the Director to take possession of the property, business and affairs of the company and to conserve the same.

(3) Upon the entry of such order, the Director shall forthwith take possession of the property, business and affairs of such foreign or alien company, and conserve the same. He shall retain such possession until, on the petition either of the Director by the Attorney General, or of such foreign or alien company, or its receiver or anyone in charge of the property, business and affairs of such foreign or alien company in its domiciliary state or country, the court, after a full hearing, shall find that the ground for such order finding cause for conservation has been removed.

(4) The rights, powers and duties of the Director as such conservator, with reference to the assets of a foreign or alien company shall be ancillary to the rights, powers and duties imposed upon any receiver or other person, if any, in charge of the property, business and affairs of such company in its domiciliary state or country.

## APPENDIX B.

The laws of the State of Ohio require companies of the type of Fidelity Assurance Association which do business in that state to make deposits for the benefit and protection of contract holders resident of Ohio. See Sections 698, 699 and 699-1, General Code of Ohio, contained in Appendix B hereof. Ohio has also provided by statute for the liquidation and distribution of such deposits in the event the depositing company fails to carry out its contract. See Section 641, General Code of Ohio, also quoted in Appendix B.

SECTION 641, GENERAL CODE OF OHIO.

If any company, corporation, or association required by law to make a deposit with the superintendent of insurance, or other state officer, to secure the contracts of such company, corporation, or association, or for any other purpose, fails to pay any of its liabilities upon such contracts, or other obligations, according to the terms thereof after the liability thereon has been determined, or if such company, corporation, or association, having ceased to do business within this state, leaves unpaid any such liability or has become insolvent, the attorney general of the state, on behalf of the superintendent of insurance, or such other officer, and upon the application of any person entitled to participate in such deposit, or

the proceeds arising therefrom, shall commence a civil action in the court of common pleas of Franklin county, making the company, corporation, or association, a party defendant, to determine the rights of all parties claiming any interest in such deposit, to subject the deposit to the payment or satisfaction of all liabilities and to distribute such fund among the persons entitled thereto.

SECTION 698, GENERAL CODE OF OHIO.

Before doing business in this state, every bond investment company shall deposit with the treasurer of state one hundred thousand dollars in cash or bonds of the United States or of the state of Ohio, or of any county or municipal corporation in Ohio, for the protection of investors in the securities of such company. Such deposit shall be made out of the paid-up capital stock of such bond investment company.

SECTION 699, GENERAL CODE OF OHIO.

The deposit made by a bond investment company with the treasurer of state shall be held as security for all claims of residents of this state against such company, and shall be liable for all judgments and decrees thereon, and subject to the payment of such decrees in the same manner as the property of other non-residents. If such company ceases to do business in this state, the treasurer of state may release securities, in his discretion, retaining sufficient to satisfy all outstanding liabilities.

SECTION 699-1, GENERAL CODE OF OHIO.

In addition to the deposits mentioned in the next two preceding sections, each such company, except those domiciled and holding certificates of authority in this state at the effective date of this act, shall deposit with the supervisor of bond investment companies, securities or assets of the kind and character permitted to be invested in by domestic life insurance companies under the laws of the state of Ohio, in an amount equal to the cash surrender value as defined in such contracts on all contracts entered into on and after the effective date of this act by such companies with persons resident in the state of Ohio, and such bond investment companies are hereby required to maintain such deposits in such amounts as are equal to such contract liabilities.

Before receiving a certificate of authority to do business in this state for the year beginning March 1, 1940, and each year thereafter, each such company, except those domiciled in this state and holding a certificate of authority at the effective date of this act, shall deposit with the supervisor of bond investment companies securities or assets of the kind and character permitted to be invested in by domestic life insurance companies under the laws of the state of Ohio, in an amount equal to the cash surrender value on all contracts entered into prior to the

effective date of this act by such companies with persons resident in the state of Ohio, and such companies are hereby required to maintain such deposits in such amounts as are equal to the contract liabilities.

All contracts or applications or subscriptions therefor entered into within the state of Ohio subsequent to March 1, 1940, by any foreign bond investment company holding a certificate of authority under the bond investment act shall contain a statement to the effect that the company maintains a deposit equal in amount to the cash surrender value as defined in said contracts in securities or assets of the kind or character permitted to be invested in by domestic life insurance companies under the laws of the state of Ohio, which deposit is segregated for the protection of contract holders resident in the state of Ohio.

All deposits required under this section shall be held by the supervisor of bond investment companies for the protection and benefit of their contract holders who are residents of Ohio.

If such company ceases to do business in this state, the supervisor of bond investment companies may release such securities or assets, in his discretion, retaining sufficient securities or assets to satisfy all outstanding contractual liabilities to persons resident of this state.

All securities or assets deposited with the supervisor of bond investment companies, hereunder, shall be deposited by said supervisor with the treasurer of state of the state of Ohio or with any federal reserve member bank or trust company approved by the supervisor of bond investment companies having a capital of not less than $1,000,000, the fees for such deposit to be paid by said bond investment company. The treasurer of state or such bank shall not deliver such securities or coupons attached thereto or assets except upon the written order of the supervisor of bond investment companies.

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CHARLES ELMORE CROPLEY
CLERK

# In the Supreme Court of the United States

**OCTOBER TERM, 1942.**

## No. 319.

FIDELITY ASSURANCE ASSOCIATION AND CENTRAL TRUST COMPANY, TRUSTEE OF FIDELITY ASSURANCE ASSOCIATION,
*Petitioners,*

vs.

EDGAR B. SIMS, AUDITOR OF THE STATE OF WEST VIRGINIA, Etc., *et al.*,
*Respondents.*

## MOTION FOR LEAVE TO FILE BRIEF AMICUS CURIAE WITH BRIEF.

DORR E. WARNER,
Hippodrome Bldg., Cleveland, Ohio,
ORLIN F. GOUDY,
Engineers Bldg., Cleveland, Ohio,
*Counsel for Victor Salkeld, et al., Amici Curiae.*

THE GATES LEGAL PUBLISHING CO., CLEVELAND, OHIO—MAIN 5647

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vs.

EDGAR B. SIMS, AUDITOR OF THE STATE OF WEST VIRGINIA, Etc., *et al.*,

*Respondents.*

## MOTION FOR LEAVE TO FILE BRIEF AMICUS CURIAE.

Now come Victor Salkeld, *et al.*, creditors of the Debtor, by Dorr E. Warner and Orlin F. Goudy, their counsel, and move the Court to grant leave to file instanter the following brief as amici curiae.


DORR E. WARNER,
1101 Hippodrome Building,
Cleveland, Ohio,

ORLIN F. GOUDY,
Engineers Building,
Cleveland, Ohio,
*Counsel for Amici Curiae.*

## BRIEF OF AMICI CURIAE.

This brief is filed on behalf of those creditors who have no security for the payment of their claims, or whose claims are insufficiently secured. It supports the petition of the Debtor and the Central Trust Company, Trustee of the Debtor (appointed by the United States District Court), for a writ of certiorari to the United States Circuit of Appeals for the Fourth Circuit.

The total number of creditors of the Debtor is about eighty-eight thousand, and its liabilities are about $23,500,000. The average claim is about $267.00. The claims fully secured or nearly so aggregate about $10,500,000. The petition for the writ is opposed by officials for four States and individual contract holders located in one State on behalf of said secured creditors.

The claims of creditors whose claims are unsecured or insufficiently secured aggregate about $13,000,000 located in forty-three States, the District of Columbia and foreign countries.

The stockholders have no interest in this proceeding because the Debtor's liabilities exceed its assets.

In the lower courts the Debtor and said Trustee sought to protect the best interests of said unsecured creditors, and in this Court they are now seeking to protect their interests. Said contract holders have had no voice in this proceeding from beginning to the end, except that of the Debtor and the said Trustee and attorneys who are friends of the Court.

If there ever was a case that needed the benefit of efficient representation in the courts this is it. The best interests of said unsecured creditors require that the Debtor and said Trustee represent them in this proceeding to the best of their ability. The Debtor and the Trustee would have been derelict in their duty if they had failed to do so.

Accordingly, there is no warrant whatever for the charge made in a brief of appellee that they have represented contract holders with improper motives.

We respectfully submit that this case is of sufficient importance and public interest to warrant this Court in granting a petition for a writ of certiorari for the purpose of making a final determination of—

1. Whether the District Court correctly applied the law in deciding that the Debtor was not an insurance company within the meaning of the Bankruptcy Act, or whether the Court of Appeals correctly applied the law in deciding that it was an insurance company within the meaning of the Bankruptcy Act.
2. Whether the District Court correctly applied the law in deciding that the petition of the Debtor was filed in good faith, or whether the Court of Appeals correctly applied the law in deciding that said petition was not filed in good faith.

Respectfully submitted,

DORR E. WARNER,
ORLIN F. GOUDY,
*Counsel for Amici Curiae.*

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# In the Supreme Court of the United States

**OCTOBER TERM, 1942.**

## No. 319.

FIDELITY ASSURANCE ASSOCIATION, *et al.*,
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vs.

EDGAR V. SIMS, *et al.*,
*Respondents.*

ON WRIT OF CERTIORARI TO
THE UNITED STATES CIRCUIT COURT OF APPEALS
FOR THE FOURTH CIRCUIT.

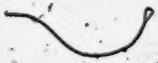
## BRIEF AMICI CURIAE OF VICTOR SALKELD, ET AL., CREDITORS OF THE DEBTOR.

DORR E. WARNER,
Hippodrome Bldg., Cleveland, Ohio,

HARRY L. DEIBEL,
Standard Bldg., Cleveland, Ohio,

*Attorneys for Victor Salkeld, et al., Creditors.*

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ON WRIT OF CERTIORARI TO
THE UNITED STATES CIRCUIT COURT OF APPEALS
FOR THE FOURTH CIRCUIT.

## BRIEF AMICI CURIAE OF VICTOR SALKELD, ET AL., CREDITORS OF THE DEBTOR.

This is a voluntary proceeding of Fidelity Assurance Association, a corporation, herein called Fidelity, for reorganization under Chapter X of the Bankruptcy Act. The District Court found that Fidelity was not an insurance company, and that its petition was filed in good faith. The Circuit Court of Appeals for the Fourth Circuit found that it was an insurance company and that its petition was not filed in good faith, and directed the District Court to dismiss the proceeding.

Accordingly, the questions presented here are:

1. Is Fidelity an insurance company?
2. Was the petition filed in good faith?

## IS FIDELITY AN INSURANCE COMPANY?

On behalf of contract holders, we contend that it is not an insurance company within the meaning of the Bankruptcy Act. A charter granting it power to do an insurance business is not the sole test of whether or not a corporation is an insurance company. Its susceptibility to the Bankruptcy Act does not depend entirely upon its charter. The business it really transacted, and the business that is to be administered by the Bankruptcy Court may be examined to determine whether it is an insurance company. Its charter is some evidence that it is an insurance company, but its actual activities may be looked into to explain or rebut such evidence. If the insurance business actually transacted is merely incidental to its primary and predominant activities, it is not an insurance company, but if its primary and predominant business is writing insurance then it is an insurance company. *Re Supreme Lodge of the Masons' Annuity*, 286 Fed. 180 (D. C.); *Re Kingston Realty Company*, 160 Fed. 445 (2 C. C. A.); *Grand Lodge, etc. v. McKee*, 95 Fed. 2d 474 (5 C. C. A.).

Congress has recognized that the judicial test of what constitutes an insurance company is sound and reasonable. It has adopted the judicial test as applied to investment companies and proceedings in bankruptcy of face amount certificate companies. Congress has declared an investment company, which includes a face amount certificate company, shall not be classified as an insurance company, unless its primary and predominant business activity is writing insurance. It has enacted a statute declaring that an investment company and a face amount certificate company in bankruptcy proceedings should not be classified as an insurance company unless it was organized as an insurance company, and unless its primary and predominant business activity is the writing of insurance. If writing insurance is merely incidental to its primary business, then it should not be

classified as an insurance company. The Investment Company Act of 1940, at the outset, provides:

> "(a) When used in this subchapter and sections 72 (a), last sentence, and 107 (f) of Title II, unless the context otherwise requires—
>
> "* * *
>
> "(17) 'Insurance Company' means a company which is organized as an insurance company, whose primary and predominant business activity is the writing of insurance or the reinsuring of risks underwritten by insurance companies, and which is subject to supervision by the insurance commissioner or a similar official or agency of a State; or any receiver or similar official or any liquidating agent for such a company, in his capacity as such."
>
> 15 U. S. C. A., par. 80a-2 (a) (17).

The subchapter is on the subject of investment companies, and section 107 (f) of Title II, above referred to, is on the subject of bankruptcy proceedings of face amount certificate companies, both of which are parts of the same act of Congress, i.e., Investment Company Act of 1940; 54 U. S. Statutes at large, Chapter 686, commencing at page 789, and commencing at page 835, respectively.

Having thus defined an insurance company, all other definitions are excluded. The doctrine of *expressio unius exclusio alterius* applies.

Measured by the test of its business activities, Fidelity is not an insurance company. Its primary and predominant business was selling annuity contracts on the installment plan, and investing the proceeds of the sales. Such insurance as it wrote, even if valid, was merely supplemental to its annuity contract and investment business. (We contend they wrote no valid insurance.)

Fidelity was organized under the laws of West Virginia in 1911, and for a period of over twenty-eight years, ending on December 31, 1940, its activities were *exclusively*

selling its own annuity contracts and investing the proceeds thereof. Prior to December 31, 1940, it did no insurance business whatever of any kind or description. Its charter granted it no power to do any insurance business. Prior to December 31, 1940, it sold 87,999 annuity contracts to purchasers located in forty-eight states, the District of Columbia and foreign countries, that are still outstanding. The face amount of said contracts is over $181,000,000, and the net cash liability of Fidelity under said contracts, as of April 10, 1941, was over $23,000,000, and the value of its assets as of June 6, 1941, was over $21,000,000. Its average liability to each contract holder was under $275.00.

By December 31, 1940, it had sustained losses to such an extent that its capital and surplus was wiped out and it had become insolvent. Its liabilities exceeded its assets. On that date, in order to avoid the requirements of the Investment Company Act enacted by Congress shortly prior thereto, its charter was amended to enable it to do a life insurance business in addition to the annuity contract and investment business. However, it did no valid insurance business after December 31, 1940.

After the charter was amended the Insurance Commissioner of West Virginia delivered a license to Fidelity authorizing it to do an insurance business for a period of three months beginning January 1, 1941, and ending April 1, 1941, but at the same time exacted a promise from Fidelity that it would do no insurance business without his permission. It sold no insurance contracts to new customers. However, it made an abortive attempt to do some insurance business with its old customers to whom it had previously sold annuity contracts. Without the permission of the Insurance Commissioner it offered riders to Series B contract holders, to be attached to their annuity contracts, without requiring the payment of any premium by the contract holder. The riders provided that Fidelity should assume certain insurance obligations. Its holders had been previ-

ously insured by Lincoln Life Insurance Company in a group policy to whom Fidelity paid the insurance premium. Lincoln Life Insurance Company continued to carry its insurance obligations the same as before. 9,802 contract holders out of 87,999 contracts outstanding accepted the riders.

The Insurance Commissioner refused to deliver a new license after April 1, 1941, and on April 11, 1941, brought an action against Fidelity in the State Court of West Virginia, wherein the State Court appointed a receiver for Fidelity. On June 6, 1941, Fidelity filed a petition to reorganize under Chapter X of the Bankruptcy Act. The District Court found that Fidelity was not an insurance company and filed its petition in good faith and approved it. On appeal, the Court of Appeals found it was an insurance company and its petition was not filed in good faith, and directed the District Court to dismiss it.

It is conceded that Fidelity was not an insurance company prior to December 31, 1940, but it is contended that the 87,999 contract holders were deprived of the benefits of Chapter X of the Bankruptcy Act because Fidelity was transformed from a face amount certificate company into an insurance company. The transformation took place when its charter was amended authorizing it to do an insurance business, and when it sent out the riders, heretofore described. We contend that the amendment and the riders did not transform Fidelity into an insurance company because its primary and predominant business activity was selling annuity contracts and investing the proceeds thereof. The riders merely supplemented contracts already sold and outstanding in the hands of purchasers. It sold no insurance contracts to old customers, except as above set forth, and sold no insurance contracts of any kind to new customers. The number of riders accepted by old customers was 9,802 out of 87,999 contracts outstanding.

We contend that the riders were not effective because—

1. The license to do an insurance business was delivered conditionally.
2. It had no paid-up capital or surplus security invested.

### 1. The License to Do an Insurance Business Was Delivered Conditionally.

The Commissioner delivered the license to Fidelity upon the express condition that it should not become effective without his permission. He exacted a promise from Fidelity that it do no insurance business without his consent. He never gave his consent, consequently the license he did deliver never became effective.

### 2. It Had No Paid-up Capital or Surplus Securely Invested.

The statute of West Virginia prohibits Fidelity doing an insurance business without $200,000 cash capital fully paid up and a like amount of surplus securely invested. On December 31, 1940, and thereafter, it had no cash capital whatever and it had no cash surplus securely invested, and it was insolvent; its liabilities exceeded its assets. Section 3326 (1) West Virginia Code provides:

> "No life insurance company shall be admitted to do business in this state, *or shall directly or indirectly enter into contracts of insurance, issue policies,* take risks or transact business in this State, unless it has at least two hundred thousand dollars cash capital fully paid up or a like amount of cash surplus, securely invested; Provided that this section shall not apply to fraternal benefit Societies organized in pursuance of the provisions of Art. 8 (Sec. 3411, *et seq.*) of this chapter."

Accordingly, we respectfully submit that Fidelity was not transformed from a face amount certificate company

into an insurance company, and its creditors by the alleged transformation were not deprived of the benefit of Chapter X of the Bankruptcy Act.

**WAS THE PETITION FILED IN GOOD FAITH?**

The answer to this question involves a consideration of two subsidiary questions:

(a) Is it reasonable to expect that a plan of reorganization can be effected?

(b) Is a proceeding pending wherein the best interests of creditors will be served?

**(a) Is It Reasonable to Expect that a Plan of Reorganization Can be Effected?**

On behalf of contract holders we contend that the petition was filed in good faith because it is reasonable to expect that a plan of reorganization can be effected, and no proceeding is pending wherein the best interests of creditors will be served.

Several plans have been considered, but because the question arose as to the want of jurisdiction of the Federal Court, no plan has been prepared and filed. It is time enough to do the work required to prepare a plan of reorganization after the question of jurisdiction has been finally disposed of. If this Court finds that the Federal Court has jurisdiction of this proceeding a plan will, in due course, be prepared and filed, but if this Court finds that the Federal Court has no jurisdiction, no plan, of course, will be prepared and filed.

Among other plans given serious consideration, is a plan contemplating the orderly liquidation of Fidelity. If liquidation over a long period of time is desired by the requisite amount of creditors, we see no reason why a plan effectuating such liquidation is not permissible under the provisions of Chapter X. Such a plan would almost neces-

sarily result in at least partial continued operation of the concern, although not for an unlimited period. Even if the old business is not to be continued, and the reorganized debtor is to limit its activities to the orderly liquidation of its assets, we see no reasen why such a plan may not be promulgated under Chapter X. Does it cease to be a reorganization if the purposes and aims of the corporate activities are changed? Or if the life of the corporation is limited?

There is no legal objection to a plan of orderly liquidation.

It is now settled that such a plan of reorganization is permissible under Section 77B of the Bankruptcy Act. *R. S. Witters Associates, Inc. v. Ebsary Gypsum Company*, 93 Fed. (2d) 746; *In re Central Funding Corporation*, 75 Fed. (2d) 256; *In re Reynolds Investing Company, Inc.*, No. 27,863 U. S. District Court of New Jersey; *In re Cuyahoga Finance Company*, No. 56,391, U. S. District Court for the Northern District of Ohio.

In *In re Reynolds Investing Company, Inc.*, John Gerdes, the well known authority on Corporate Reorganization, prepared such a plan of reorganization. In his report as trustee of the Debtor, he said:

> "The plan proposes liquidation through the medium of a reorganized Debtor rather than through an adjudication in bankruptcy, because: (1) the extent of the solvency of the Debtor is uncertain, and a judicial determination of the extent of such insolvency would involve protracted litigation, be expensive, and, in the end, be useless; (2) complete and satisfactory liquidation is a practical impossiblity within the time ordinarily contemplated by bankruptcy or other liquidation through legal proceedings; (3) corporate management is more flexible and better able to meet unforeseen contingencies in a liquidation over a long period of time than is the case where the liquidation is managed by officers of a court; and (4) control of liquidation which

necessarily extends over a long period of time should be under the direct and immediate control of those primarily interested—the debenture holders and stock owners."

The decisions of the Court in the cases of *R. S. Witters Associates, Inc. vs. Ebsary Gypsum Company*, 93 Fed. (2d) 746, and *In re Central Funding Corporation*, 75 Fed. (2d) 256, holding that a plan of orderly liquidation was permissible under Section 77B of the Bankruptcy Act, was before Congress at the time it amended the Act by enacting Chapter X, and since Congress did not see fit to exclude such a plan of reorganization, it must be presumed that Congress approved the judicial construction given its prior legislation of substantially the same import. *Re Wisc. Nat. Bank v. Wisc. Cooperative Milk Pool*, 119 Fed. (2d) 999 (7 C. C. A.).

Such a plan is permissible under the Chandler Act. Thus in *In re Porto Rican American Tobacco Company*, 112 Fed. (2d) 655, in a proceeding to reorganize the debtor under Chapter X, the Second Circuit Court of Appeals held that such a plan of reorganization was permissible. The appellant urged that such a plan is not permissible because such a plan does not constitute a plan of reorganization, but only a method of liquidation. On appeal from an order of the District Court approving such a plan at page 667 the Court held in part:

"* * * * but the plan involving ultimate liquidation is not contrary to the terms of the reorganization provision of the Bankruptcy Act. * * *"

An exhaustive search discloses there are no decisions to the contrary either under Section 77 B or Chapter X of the Bankruptcy Act.

We therefore respectfully submit that it is reasonable to expect that a plan of reorganization can be affected.

**(b) Is a Proceeding Now Pending Wherein the Best Interests of Creditors Will be Served?**

We contend that no proceeding is now pending wherein the best interests of creditors will be served. Twelve separate proceedings are now pending in the courts of twelve different states. These are the states wherein Fidelity deposited securities to secure the payment of contract holders. The best interests of creditors will not be served by any one or all of said state court proceedings because—

(1) The Federal Court has jurisdiction to approve and confirm a plan of reorganization of Fidelity and no state court proceeding is pending to reorganize Fidelity, and no state court has jurisdiction to approve and confirm a plan of reorganization.

(2) The decision of the Federal Court in respect of controversies in relation to its assets and liabilities will be uniform, and there is no assurance that the decisions of the state courts will be uniform.

(3) If liquidation is desired by the requisite amount of creditors, their best interests will be served if the Federal Court retains jurisdiction, because—

(a) A liquidation through the medium of a reorganized debtor is better than piece-meal liquidation in twelve separate court proceedings.

(b) A single corporate management is more flexible and better able to meet unforeseen contingencies in a liquidation over a long period of time than is the case where the liquidation is managed by officers of twelve different courts.

(c) Control of a liquidation which necessarily extends over a long period of time should be under the direct and immediate control of those primarily interested—the contract holders.

## CONCLUSION.

We therefore respectfully submit that—

1. Fidelity is not an insurance company.
2. The petition was filed in good faith.

Respectfully submitted,

DORR E. WARNER,

HARRY L. DEIBEL,

*Attorneys for Victor Salkeld, et al., Creditors.*

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IN THE

# Supreme Court of the United States

OCTOBER TERM, 1942

## No. 319

FIDELITY ASSURANCE ASSOCIATION, a corporation, Debtor, and CENTRAL TRUST COMPANY, Trustee for Fidelity Assurance Association,

*Petitioners,*

vs.

EDGAR B. SIMS, Auditor of the State of West Virginia and Ex Officio Insurance Commissioner of the State of West Virginia; H. ISAIAH SMITH and ROSS B. THOMAS, West Virginia State Court Receivers; BANKING COMMISSION OF WISCONSIN; CHAS. R. FISCHER, Commissioner of Insurance and Permanent Receiver for debtor corporation in and for the State of Iowa; JOHN B. GONTRUM, Insurance Commissioner of the State of Maryland; DEWEY S. GODFREY, Missouri State Court Receiver; L. H. BROOKS, Trustee, FREDERIC LEAKE AND A. L. GOLDBERG, JR., Trustee; and SECURITIES AND EXCHANGE COMMISSION,

*Respondents.*

**BRIEF OF EDGAR B. SIMS, AUDITOR AND EX OFFICIO INSURANCE COMMISSIONER OF THE STATE OF WEST VIRGINIA, AND H. ISAIAH SMITH AND ROSS B. THOMAS, WEST VIRGINIA STATE COURT RECEIVERS, IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT.**

IRA J. PARTLOW,
*Assistant Attorney General of West Virginia,*
*Attorney for West Virginia Respondents.*

W. S. WYSONG,
*Attorney General of West Virginia.*

KOONTZ & KOONTZ,
By: *J. Campbell Palmer, III,*
*Of Counsel for West Virginia Respondents.*

JARRETT PRINTING COMPANY, CHARLESTON, W. VA.

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## No. 319

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FIDELITY ASSURANCE ASSOCIATION, a corporation, Debtor, and CENTRAL TRUST COMPANY, Trustee for Fidelity Assurance Association,

*Petitioners,*

VS.

EDGAR B. SIMS, Auditor, etc., et al.,

*Respondents.*

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**BRIEF OF EDGAR B. SIMS, AUDITOR AND EX OFFICIO INSURANCE COMMISSIONER OF THE STATE OF WEST VIRGINIA, AND H. ISAIAH SMITH AND ROSS B. THOMAS, WEST VIRGINIA STATE COURT RECEIVERS, IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT.**

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## STATEMENT AND OPINIONS BELOW

Fidelity Assurance Association of Wheeling, West Virginia (hereinafter called the "DEBTOR"), and Central Trust Company of Charleston, West Virginia (hereinafter called the "TRUSTEE"), have petitioned this Court for the issuance of a writ of certiorari to the United States Circuit Court of Appeals for the Fourth Circuit to review a decision of that Court entered on the 16th day of June, 1942 (rehearing denied July 22, 1942), reversing an order of the United States District Court for the Southern District of West Virginia entered Janu-

ary 5, 1942; which order sustained that District Court's jurisdiction to entertain the Debtor's petition for reorganization under Chapter X of the Bankruptcy Act, and overruled certain motions to vacate orders of the District Court with reference to the custody and control of securities deposited by the Debtor, in accordance with State law, with States and officials thereof in each of fifteen States of the United States. The Circuit Court of Appeals ordered the case remanded for the purpose of dismissing the Debtor's petition on the ground that Debtor was an insurance company when its petition was filed on June 6, 1941, and that the said petition was not filed in good faith as defined in Section 146, particularly (3) and (4), of said Chapter X. The opinion of the District Court (Moore, D. J.) is reported in 42 F. Supp. 973 (S. D. W. Va.), and the unanimous opinion of the Circuit Court of Appeals is reported in 129 F. (2d) 442.

## JURISDICTION

The order of the Circuit Court of Appeals was entered on June 16, 1942 (R. 387) (rehearing denied July 22, 1942 (R. 397)). The petition for a writ of certiorari was filed on the 20th day of August, 1942. The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code, as amended by the Act of February 13, 1925 (28 U. S. C. A. 347) and Section 24(c) of the Bankruptcy Act (11 U. S. C. A. 47(c)).

## STATUTES INVOLVED

(Set out in full in Appendix A)

Section 4 of the Bankruptcy Act as amended by the Act of June 25, 1910, 36 Stat. 839, 11 U. S. C. A. 22.

Section 141, Chapter X of the Bankruptcy Act (11 U. S. C. A. 541).

Section 144, Chapter X of the Bankruptcy Act (11 U. S. C. A. 544).

Section 146 of the Bankruptcy Act, and parts (3) and (4), (11 U. S. C. A. 546).

Sections 156 and 158(4), Chapter X of the Bankruptcy Act (11 U. S. C. A. 556, 558).

Section 9(a) (b) of the Investment Company Act of 1940 (15 U. S. C. A., Sec. 80a-9(a) (b)).

Code of West Virginia, Chapter 31, Article 1, Section 73[1].

## STATEMENT OF THE CASE

### Foreword

There are seven respondents in this case (R. 363 for official designation, and 42 F. Supp. 476 for their official representation) who filed joint and several appeals in the Circuit Court of Appeals, six of whom filed controversial answers in the District Court to the Debtor's petition; five of them, for the purposes of brevity, will be referred to hereinafter as the Wisconsin, Iowa, Missouri, Tennessee and Maryland respondents. This brief is being filed jointly in behalf of Edgar B. Sims, Auditor and ex officio Insurance Commissioner of the State of West Virginia, and H. Isaiah Smith and Ross B. Thomas, West Virginia State Court Receivers (R. 3), hereinafter referred to jointly as the West Virginia respondents, and separately as Auditor of West Virginia and West Virginia Receivers.

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1 Other statutes involved by reason of questions presented below, but not there determined, are: Code of W. Va. 12-5-2, 6; 33-9-3, 10; 33-2-45; 33-2-12; Art. VI., Sec. 35, Const. of W. Va.; Tenth Amendment to the Const. of the U. S.; Eleventh Amendment to the Const. of the U. S.; Sec. 111 of Ch. X of the Bankruptcy Act (11 U. S. C. A. 511); Sec. 116(1), Ch. X of the Bankruptcy Act (11 U. S. C. A. 516); Sec. 128, Ch. X of the Bankruptcy Act (11 U. S. C. A. 528); Sec. 216(4) of Ch. X of the Bankruptcy Act (11 U. S. C. A. 616); Statutes of the States where Debtor made deposits, set out in the Appendix of each brief discussing such statutes.

Four briefs will be filed in opposition to the petition for writ of certiorari on behalf of the respondents, Wisconsin and Iowa respondents filing a joint brief, Tennessee and Missouri respondents filing jointly, and Maryland filing separately. Counsel representing the respondents have agreed to divide the legal points and arguments thereon among themselves. It will, therefore, be necessary for the Court, if it will, to consider all of the briefs filed in opposition jointly as one composite brief, in order to reach a complete understanding of the points raised in opposition.

Only this brief of the West Virginia respondents will contain the "Statements and Opinions Below," the grounds upon which "Jurisdiction" is invoked by the petition, and a list of the "Statutes Involved," with each of the briefs filed setting out in full those particular statutes with which that brief will concern itself.

Each brief will include in its "Statement of the Case" only so much as is necessary to argue the points of law intended to be raised in that brief; each will contain a statement of the "Issues" with which it will deal; each will contain in its appendix such parts of the typewritten record, sent by the respondents to the Circuit Court of Appeals, but not printed by petitioners here, as are deemed necessary.[2] We hope that this procedure will merit the Court's approval.

(All emphasis in this brief is by counsel, unless otherwise noted.)

## Statement

The opinion of the Circuit Court of Appeals contains a complete and accurate summary of the facts upon which the points of law decided in that opinion were based.

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2. "R. ____" will be used to denominate the page of the record as printed for this Court, and "T. ____" will be used to designate the page of the typewritten transcript. Reference to exhibits of the record sent to the Circuit Court of Appeals will be made by "Exh. ____, p. ____"

The opinion of the District Court (R. 3, 4) (42 F. Supp. 973, at 976) correctly sets forth how the case arose, and (R. 16, 17) (p. 981) correctly sets forth the contentions of your respondents which were therein raised.[3] The statement of facts of the District Court (R. 4-17) (42 F. Supp. at 977-981) is substantially correct, but not entirely complete. It is necessary to supplement those facts with those which follow, in order to argue correctly the issues hereinafter discussed in this brief.

In August, 1940, F. H. Pulfer, Sales Manager and Director of Debtor, brought to it one Allen G. Messick (T. 794), a Chicago promotor, who was to furnish or procure $500,000.00 to enable Debtor to continue business (T. 796). Over fifty per cent. of both the preferred and common stock of Debtor was then trusteed in John Marshall, of Washington, D. C. (R. 298, Exh. No. 95), for the purpose of enabling him to deal with Messick. Marshall's father-in-law had been one of the five founders of Debtor, and Marshall had been on its payroll at least since 1929 (T. 2939), and had served the company as its attorney, general counsel, chairman of the board, and in various other ways, for many years. For many years it had paid a part of his office rent, telephone bills, and stenographic expenses (T. 2910-11). Marshall apparently never purchased more than 110 shares of its stock, but by stock dividends came to own 750 shares of common and 275 shares of preferred stock (See Trustee's Partial Section 167 Report, p. 50). His son, John Marshall, Jr., shortly after leaving college, was made a vice-president and director of the Debtor (T. 967-8), and after Messick became chairman of the board, an assistant treasurer.

The Messick deal fell through. No money was furnished and Messick, who purportedly had come to bring money,

3 These same contentions were advanced in the Circuit Court of Appeals, whose decision was based upon only two of them (R. 363).

stayed as chairman of the board at a salary of $1,000.00 a month (T. 872) until Auditor Sims of West Virginia learned of it and prohibited further payment (T. 518-19-88). After April 11, 1941, when Auditor Sims instituted statutory receivership proceedings for the Debtor in West Virginia, with the Debtor's consent, and after the Debtor's directors had unanimously agreed to State Court proceedings in preference to any other proceedings (See Exh. of Minute Book of Board of Directors' Meetings, pp. 173-174), Messick interested an old school friend, James R. Fleming, an attorney of Fort Wayne, Indiana (T. 3601-2), who then undertook to look out for Mr. Marshall's stock interests. (T. 2974-75, 2446, R. 189, 190.)

Six of the eight directors of Debtor met in Pittsburgh, Pennsylvania, on June 3, 1941, in a purported directors meeting (T. 1680-82; R. 13) (42 F. Supp. 980), after Marshall, Messick and Fleming had conferred together (T. 2965, 2971, 2994). These six were Marshall and Marshall's son, both of whose services had been dispensed with by the State Court Receivers (T. 3796), the latter owing, and ill owing, Debtor over $1,000.00 for rent on his home as ell as unpaid checks issued by him to Fidelity, which indebtedness Auditor Sims of West Virginia insisted should be paid (T. 547); Pulfer, who had not only been discharged by the Receivers but who owed the company $8,000.00 which he had drawn as advance salary and had not repaid, and did not think he should, and which Auditor Sims insisted must be repaid (T. 812); Messick, who had been let out by the State Court Receivers and who, on the day of their appointment, requested payment for the back salary which Auditor Sims had prevented him from getting (R. 143); Howard Reed, Vice-President, and A. L. King, who had not been retained by the West Virginia Receivers. Needing a seventh director for a

quorum, they purported to elect Fleming, who was there by invitation, a director for the purpose of the meeting, although he was not, and never became, a stockholders, as required by By-Law No. 6 (R. 187) (T. 378, 1678) (R. 13) (42 F. Supp. 980), and who stated that in the light of future matters he deemed it preferable for him not to become a member of the board and serve thereon, but as an emergency confronted them, he would consent to become a member of the board to make a quorum, but that he would resign at the close of the meeting, and who did purportedly resign immediately after the meeting (R. 14) (42 F. Supp. 980). This meeting then voted to file the instant petition in bankruptcy, under Chapter X, in behalf of the Debtor, and on June 6, 1941, Fleming, together with Messick, did file the instant petition (T. 3601-2, 925) (R. 14) (42 F. Supp. 980).

Immediately after the petition was filed, the District Court, *ex parte*, approved the petition as being filed in good faith and having all the necessary requisites for the Court's jurisdiction under Chapter X (R. 323, 324), and appointed the Central Trust Company, of Charleston, West Virginia, the Trustee (R. 3, 324) (42 F. Supp. 976). On the following morning, June 7, 1941, still *ex parte*, upon petition by the Trustee, the Court appointed Townsend and Townsend, of Charleston, West Virginia, as the attorneys for the Trustee, and on further petition by the newly appointed Trustee, the Court authorized the Trustee to employ Fleming and Messick "for the purpose of assisting your Trustee in marshaling the assets of said Debtor which are now situate in divers states outside the territorial limits of the State of West Virginia, and also for the purpose of assisting Trustee in the development and formulation of a plan or reorganization for the affairs of Debtor in this proceeding, and that your Trustee be also authorized by the Court to employ the above

named to perform any other special services other than that of general counsel for the Trustee * * *."

The respondents thereafter contended that Messick and Fleming had been employed by the Trustee, and although it was shown, and not denied, that they went to the State of Wisconsin, at the request of Townsend and Townsend, the Trustee's attorneys (R. 166), conferred with officials there (R. 153), and conferred with the officials of many of the depository States the next day in Chicago, and stated that they had been retained by the Trustee and authorized to speak for it (R. 150), the District Court during the hearing stated that they were never employed by the Trustee (R. 294) and during the hearing refused to receive any evidence which would tend so to show (R. 163), and later, in its opinion, so held (R. 16) (42 F. Supp. 981).

Immediately after their appointment, State officials, particularly those in West Virginia, challenged the right of Messick and Fleming to be employed by the Trustee (R. 162); Messick's appointment was promptly rescinded and that of Fleming by order of August 1, 1941 (R. 16) (42 F. Supp. 980).

As set out by the District Court (R. 4) (42 F. Supp. 976-77), immediately upon filing the petition, turn-over orders, later modified to "freezing" orders (on Aug. 9, 1941) were issued to all State officials with regard to the deposited funds held by them. Certain of the States thereupon filed controversial answers and made motions to vacate these turn-over and "freezing" orders, Maryland appearing specially for that latter purpose (R. 199). Hearings were had before the District Court on the issues joined, beginning on August 5, 1941, and lasting intermittently until October 10, 1941 (R. 4).

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4 Petition and order June 7, 1941, a part of the record sent to the Circuit Court of Appeals.

Fleming appeared in the District Court as the attorney for the Debtor (42 F. Supp. 976), although never authorized so to do other than by the meeting of the board of directors above set out.

The District Court, after a full hearing on this question, held (R. 21):

> "The purported directors meeting of June 3, 1941, was not a legal meeting and the directors could not at that meeting grant any valid authority to any person to file the petition for reorganization."

## Purported Ratification Meetings

### September 17th Meeting

On September 17, 1941, the six directors who had purportedly met in Pittsburgh were all summoned, in Debtor's behalf, to testify at the hearings before the Court, at Charleston, West Virginia. (R. 138.) On that day as well a meeting of the board of directors was called, at which Messick, Marshall, Marshall's son, Pulfer and Reed attended, as well as D. A. Burt, A. L. King having in the meantime resigned. An offer of proof was made to the District Court which was rejected, that the president of the corporate Trustee herein attempted to persuade A. L. King to attend that directors meeting. (R. 136, 137). As well as the six directors mentioned, Wheeler Bachmann was present, he having been elected a director at the annual meeting of the Debtor in February, 1941 (Exhibit of Directors' Minutes, p. 172), and who had, upon notification thereof, declined in writing immediately thereafter to serve as such director (Exhibit Board of Directors' Minutes p. 177) (R. 15, 22). Marshall and Messick in their testimony earlier in the hearing had sworn that Bachmann was not a director on June 3, 1941 (T. 886-8-9, 422, 435).

With Bachmann present to complete their quorum, the six directors purportedly elected Marshall's nephew, Philip Paull (R. 15), to the board, and with these seven directors present, Bachmann not participating (Exh. Minutes of Board of Directors, p. 179), they purportedly ratified the authorization of June 3rd in filing the petition on June 6th (42 F. Supp. 983). No permission of the District Court to elect Paull a director was obtained as required by Section 191 of Chapter X.

The minutes of this meeting were immediately brought to Court and introduced in evidence, and after adjournment of Court on that day, Bachmann purportedly resigned from the board (Exh. Board of Directors' Minutes, p. 181).

### New Attorneys for Debtor

Shortly thereafter, Fleming quit the trial and never reappeared, and although his name has continued to be used, has never since appeared at any hearing or argument in either the District Court or Circuit Court of Appeals, and no communication or answer to such has ever since that time been received by any counsel for respondents. Taking his place came John V. Ray, of the firm of Payne, Minor and Ray, of Charleston, West Virginia, who are listed in Martindale in both 1941 and 1942, as general counsel of the Central Trust Company, the disinterested Trustee herein, and that general representation has not been denied. Mr. Ray has since represented Debtor, although his right so to do, without corporate authorization, was promptly, and still is, challenged.

After the decision of the Circuit Court of Appeals, Mr. Homer Holt, beginning July 13, 1942, has acted with Mr. Ray as counsel for the Debtor, and he frankly admits that his firm is private counsel for the Central Trust Company,

Trustee herein, and it has advised with him concerning its private liabilities in connection with this estate, and that he was requested to appear for Debtor only by Mr. Marshall.

### October 3rd Meeting

The next time testimony was taken before the District Court, Mr. Ray, as attorney for the Debtor, apparently abandoned the legality of this September 17th meeting (T. 2263), and failed to produce Mr. Marshall for cross-examination concerning that meeting, and asked permission of the Court to hold a further meeting of the board of directors and stockholders, and to reelect the old group as new officers and directors.

Section 9(a) of the Investment Company Act of 1940 (15 U. S. C. A., Sec. 80a-9(a)) makes it unlawful for anyone to serve as an officer or director of a company when such person is enjoined from "engaging in or continuing any conduct or practice in connection with * * * the purchase or sale of any security * * *." All of the officers and directors, except Messick, were enjoined in the Detroit suit brought by the Securities and Exchange Commission in 1938, in the consent decree entered therein, from engaging in certain practices in the sale of Debtor's securities. (42 F. Supp. 979; R. 10; Exh. 6, pp. 97-258.) Marshall and others had applied to the Securities and Exchange Commission for permission to serve as directors and exemption from this provision, as provided in Section 9(b) of the Act. It had not been granted (R. 22). Therefore, objection was made that the District Court was without power to give permission, under Section 191 of Chapter X, to these men who had been enjoined, to serve as officers and directors of the company.

It was further objected that permission to hold such meeting should only be granted upon condition that the

equitable owners of the stock be permitted to vote it and not have it voted by Marshall, in whose name it was still trusteed. Since it was undenied that at least under West Virginia law the company had become an insurance company on December 31, 1940, the insurance laws of West Virginia (Ch. 31, Art. 1, Sec. 73) prohibiting a voting trustee for stock in any insurance company, it was argued to the Court that the Court should not give Marshall permission to vote this stock in ratification of his own acts.

The District Court overruled all objections and granted permission to hold stockholders and directors meetings, which were held on October 3, 1941. At the stockholders meeting the tellers reported 9,887 shares present out of a total of 17,235 shares, and Marshall, as trustee, voted 9,570 shares (Exh. of Minute Book of Directors' Meetings, p. 191). Ratification was voted by him of the former directors meetings and of the filing of Debtor's petition, and new directors were elected, among whom was Marshall's nephew, Philip Paull, and his brother-in-law, James Paull. These directors then not only ratified all acts that Marshall had previously done, but ratified a resolution passed at the purported meeting of September 17th, as follows:

> "RESOLVED, further, that John Marshall, Sr., be, and he is hereby authorized, directed and empowered to do such acts and sign such papers as may be necessary to prosecute the pending proceedings, or a new proceeding, for a corporate reorganization under Chapter X of the Federal Bankruptcy Act."

The District Court, in its opinion, held the meetings of September 17th and October 3rd valid corporate meetings, and the ratifications therein voted, ratified and validated that which was done at the meeting of June 3rd,

and therefore that the petition had been properly filed (R. 23) (42 F. Supp. 984).

The District Court, in its opinion (R. 27, 30) (42 F. Supp. 985, 987), however, held that the stockholders of the Debtor had no interest of any kind whatsoever in its assets, which was confirmed by the Circuit Court of Appeals (R. 383). This controversy is being carried on, and this petition is filed on behalf of stockholders *only*, who have had, up to the present time, the Trustee pay all of their costs and expenses, except counsel fees, out of the funds of the contract holders in the possession and under the control of the Trustee, and without any corporate authority on the part of the Debtor, other than that which is set out above, and over the continued objection and protest of a number and groups of contract holders.

Immediately after the Federal proceedings were instituted, not only State officials but numerous contract holders and groups of contract holders contested the bankruptcy proceedings, and have been doing so ever since. During the existence of the State Court proceedings of April 11th to June 6th, in West Virginia, there was only one objection filed on behalf of a single contract holder to those State Court proceedings. That was filed by the same firm of attorneys of which Mr. Holt is a member, and who now represent the Debtor, and the substance of that objection was that there should be a corporate receiver appointed instead of solely individual receivers.

Over numerous objections and exceptions, the attorneys appointed for the Trustee, throughout the hearings of the District Court, engaged in that jurisdictional controversy and undertook to sustain Debtor's petition and the jurisdiction of the District Court which appointed that Trustee and those attorneys. (T. 3620, 3625, 3634, 3642, 3644.)

## QUESTIONS PRESENTED

Of th questions, only the following are discussed in this brief:

I. Debtor's petition was not filed in "good faith" as that term is ordinarily used, nor as defined in Section 146(4), Chapter X, and there was never any valid corporate authority authorizing the petition to be filed.

II. The petitioners herein, that is the Trustee and those acting purportedly in behalf of the Debtor, cannot rightfully file a petition for writ of certiorari.

(The following questions were presented below, but not discussed nor decided in the opinion there, and are discussed briefly hereinafter, in an "Addendum" to this brief, as substantiating the correctness of the decision and judgment of the Circuit Court of Appeals):

III. The Eleventh Amendment to the Constitution of the United States prohibited the District Court from taking jurisdiction over the funds deposited with the States and over the State officials having custody and control thereof.

IV. The petition was not filed in the proper venue, under Section 128 of Chapter X, and under Section 111, the Debtor had no property within the District Court's territorial jurisdiction.

V. The orders of the District Court directed against State officials are void under the Tenth Amendment to the Constitution of the United States.

VI. The delivery of securities by the Debtor under the depository laws of the various States constituted contracts in the public authority within the meaning of Chapter X of the Bankruptcy Act, which the District Judge could not permit to be rejected.

## SUMMARY OF ARGUMENT

The decision and judgment of the Circuit Court of Appeals in ordering the dismissal of Debtor's petition filed under Chapter X of the Bankruptcy Act was correct.[5]

### I

A. Debtor's petition under Chapter X was not filed in "good faith" as that term is generally and equitably defined, in that minority stockholders, being certain of Debtor's former officers and directors who, by decision of both the Courts below, have no remaining financial interest or equity in Debtor, filed that petition and have since carried on the controversy, including the filing of the petition for writ of certiorari, for their own interests and not those of the contract holders, and all of which has been done entirely by the use of funds belonging solely and exclusively to the contract holders and creditors.

B. The petition was not filed in "good faith" as that term is defined in Section 146(4) of Chapter X, in that the prior proceedings then pending in the States, particularly in West Virginia, would best subserve the interests of the contract holders. Deposits of securities were made by Debtor with each of thirteen States for the benefit and protection of the contract holders in those States, as required by the laws of each of those States. Liquidation and distribution of those deposited securities can and should be performed by the proper officials and under the laws of each of those States, as interpreted by their own State courts, and working in cooperation with the officials of each of the other States; instead of having liquidation and distribution by the Federal Trustee ap-

5 The questions presented, which were raised below but not decided there, are discussed merely cursorily in this opposition brief, and summary thereof is therefore presumed unnecessary.

pointed under Chapter X (rehabilitation of the company being concededly practically an impossibility), and the laws of each of those thirteen depository States being interpreted by the one Federal District Court.

C. As set forth fully in the Statement of Facts and in the Opinion of the District Court (42 F. Supp. at 983), the corporate meeting purportedly authorizing the original filing of Debtor's petition on June 6, 1941, "was not a legal meeting and the directors at that meeting could not grant any valid authority to any person to file the petition for reorganization," and since, as respondents contend, no other valid corporate meeting was held; and since no ratification could be had for the invalid filing of the Debtor's petition; and because the directors enjoined in the Securities and Exchange Commission suit in Detroit in 1938 by acting in violation of Section 9(a) of the Investment Company Act of 1940 were prohibited from performing any valid action, then the petition was never lawfully and validly filed; hence the decision ordering the petition dismissed was correct.

II

A. Sections 156 and 158(4) of Chapter X require that the Trustee appointed by the District Court be disinterested and have no interest in the Debtor or any interest materially adverse to the interests of any class of creditors. Therefore, the instant Trustee has no proper interest in the merits of Debtor's petition, or attempting to sustain it, and no proper interest in attempting to sustain the jurisdiction of the Court appointing it, and consequently no right to apply for a writ of certiorari to a judgment dismissing the petition.

B. Those stockholders who have caused this petition for writ of certiorari to be filed in the Debtor's name have,

by the decisions of both Courts below, no financial or equitable interest remaining in the Debtor and its former assets. Hence, they have no right to continue this controversy for interests of their own, and to do so entirely with funds belonging solely to the contract holders.

## I

## DEBTOR'S PETITION WAS NOT FILED IN GOOD FAITH

### A

### Lack of Good Faith as that Term Is Generally Defined

The controversial answer of Edgar B. Sims, Auditor of the State of West Virginia, and the answer of the West Virginia Receivers,[6] sets forth that the Debtor's petition[4] itself shows that those filing it were not acting in "good faith", because the petition, in paragraph IX,[4] states that it is the desire of the Debtor that a plan of reorganization be effected and a Trustee be appointed to formulate it, because the Debtor will be unable to meet its obligations as they mature "unless the rights of the contract holders are modified so that the earnings received on securities and assets owned by Debtor will be sufficient in amount to meet the requirements under its outstanding contracts; if the rights of its outstanding contract holders are modified to this extent, the Debtor will be able to meet its reserve requirements and will be able to resume the operation of its business."

Under *Case* v. *Los Angeles*, 308 U. S. 106, 60 S. Ct. 1, 85 L. Ed. 110, clearly this modifying of creditors rights solely for the benefit of the stockholders could never be

6 These pleadings were part of the record sent by these appellants to the Circuit Court of Appeals, and they, as well as all of the other pleadings, inexplicably are not in the printed record filed in this Court.

permitted under Chapter X, and therefore the petition should have been instantly dismissed.

Sections 141 and 144 require that the petition be filed in good faith, and Section 146, in defining "good faith," specifically does not limit it to the statutory definition.[7]

"Good faith" has been variously defined as "Consists in an honest intention to abstain from taking any unconscientious advantage of another;" "is purely a question of fact;" "the state of mind of the party;" "as the actual existing state of mind."

Black's Dictionary, 2d Ed., 544.
*Searl* v. *School District*, 133 U. S. 553, 33 L. Ed. 740.

Gerdes, in his article on "Corporate Reorganization," 52 Harvard Law Review 8, states:

> "The judge's satisfaction as to the good faith of petitioners continues to be an essential requirement for approval of petition."

In 48 Harvard Law Review, in the note on pages 287, 289, it is stated:

> "Whatever else 'good faith' signifies, it at least demands *honesty of purpose.*"
>
> "However honest the purpose of the petition, if his primary object is not to protect his interest as a creditor, the petition is not filed in 'good faith'; * * *." (Page 289.)

Most of the writers and judges insist that the *intentions* of those who file a petition must be honest, and that if there is legal or equitable fraud in filing the petition, it

7 The history and background of this phrase "filed in good faith" is set out (R. 118-119). It is submitted that that phrase means *bona fides*.

must be dismissed. Creditors and stockholders who might incidentally be served by such proceedings can then file a proper petition themselves.

In Finletter, The Law of Bankruptcy Reorganization, 35 (1939), the history of Chapter X is set forth, and the author states, as to Section 77B and Chapter X:

> "The reorganization chapters must therefore be regarded as adopting the principles of the equity receivership which was the model for the 1933 and 1934 acts. It is accordingly in the light of these principles, rather than of the liquidation concept which underlies the decision in ordinary bankruptcy, that the reorganization provision must in the main be interpreted."

In 49 Harvard Law Review 1111, at 1123, it is stated:

> *"It is clear that the petitioner must show at least honesty of purpose, motive, and intent."*

Sustaining cases are cited in Note 87, p. 1124.

So "good faith" is merely an extension of the equitable doctrine of "clean hands," a change in nomenclature without any change in substance; and where those filing the petition did not act in "good faith" or *bona fides*, and came into court with "unclean hands," the petition has been dismissed.

*In re Northeastern Water Companies*, D. C. N. Y., 24 F. Supp. 659.

*In re Cook*, 104 F. (2d) 981.

*Wisun* v. *Golub* (2d C. C. A.), 84 F. (2d) 1.

*In re North Kenmore Building Corp.* (7 C. C. A.), 81 F. (2d) 656.

The West Virginia respondents' controversial answer, filed in the District Court, charges that Marshall, Messick and Fleming dominated the bringing of this instant petition; that their plan was, in bringing a Chapter X proceeding, to have all of the assets taken away from the various State officials and concentrated under one person, a Federal Trustee; that they would then be employed by the Trustee, and be in active charge of that twenty million dollar fund; that they knew, all three being competent lawyers, that there was no possibility of rehabilitation; and that if they originally brought straight bankruptcy proceedings in Federal Court, the lienholders, or State officials, would keep charge of those funds and turn over to the Federal Bankruptcy Trustee only such balances, if any, as were left after the liens were satisfied, that is, the claims of contract holders paid; that under Chapter X proceedings all of the funds could supposedly be collected into the Trustee's hands and that when rehabilitation was thereafter found to be impossible, liquidation would ensue in Federal Bankruptcy Court, with the entire funds collected being turned over en masse to that Bankruptcy Trustee, with the same three gentlemen still in charge of the liquidation and distribution. Thus, by court procedure they would have charge of the liquidation and distribution of more than twenty million dollars, together with the emoluments, fees and expenses therefor.

Such was the charge made in the answer. The facts asserted in these respondents' answer to prove it were: An invalid corporate meeting was held June 3, 1941, authorizing the petition to be filed; the Debtor's petition was filed in the late afternoon of June 6, 1941, by Fleming and Messick, and the Trustee was immediately appointed; that the next morning that Trustee presented a petition to employ Townsend and Townsend as its attorneys and general counsel, which petition the Court granted;

that at the same time the Trustee presented its petition requesting authorization from the Court to employ Messick and Fleming "for the purpose of assisting your Trustee in marshaling the assets of said Debtor which are now situate in divers States outside the territorial limits of the State of West Virginia; also for the purpose of assisting Trustee in the development and formulation of a plan or reorganization for the affairs of Debtor in this proceeding; that your trustee be also authorized by the Court to employ the above named (Fleming and Messick) to perform any other special services other than that of general counsel for the Trustee in the administration of this trust * * *." The Court immediately (June 7, 1941) entered an order granting said petition and authorizing said employment.

At the hearing before the District Court, the above facts being admitted, the respondents attempted to prove that Messick and Fleming were then immediately employed by the Trustee, and the District Court stated from the bench that they had never been employed and he would not permit any evidence to be introduced on that subject. (R. 160, 16.

It was nevertheless brought out in that hearing that at the request of Townsend and Townsend (R. 166), the Trustee's appointed general counsel, Messick and Fleming left immediately for Wisconsin (R. 166) and there conferred with the officials in charge of the deposited securities (R. 153); that they stated that they represented the Trustee and were entitled to act for it (R. 153); that they wanted the Wisconsin officials to work with them (R. 167), and without friction, in turning over the Wisconsin assets to the Trustee (R. 153-154). On the following day Fleming appeared in Chicago before a meeting of the officials of the States which had deposits of securities made by Fidelity (R. 154), and there reiterated that while

he had been originally engaged to look out for Mr. Marshall's stock interests (R. 149), he was there at that meeting speaking to those State officials for and on behalf of the Trustee, at its request (R. 150), and asked those officials to turn over their funds to and cooperate with the Trustee in the prosecution of the proceedings, and conferred with them at length concerning the affairs of Fidelity (R. 150). All of this evidence was undenied by Mr. Fleming and Mr. Messick (R. 154), but nevertheless the District Court held, in its written opinion (42 F. Supp. at 981; R. 16), "Messick and Fleming were never actually employed by the Trustee," and held during the hearing, "Mr. Messick nor Mr. Fleming have ever had any connection with the Trustee." (R. 293.)

After the States objected to the authorization to the Trustee to employ Messick and Fleming, the District Court immediately had such authority concerning Messick revoked, and on August 1, 1941, by written order, had the authority concerning the employment of Fleming revoked, and in his written opinion held (42 F. Supp. at 981; R. 16):

> "The Court at first authorized such employment but later, being of opinion that it would not be for the best interests of all parties concerned, revoked such authority. * * *"

Objection was made to the District Court that the former officials and directors who had been enjoined by the Securities and Exchange Commission suit in Detroit in 1938 could not continue to act purportedly for the Debtor company and dominate its affairs, and that by so doing they were violating the law, in that such was forbidden by the Investment Company Act of 1940, Section 9(a); they were nevertheless expressly permitted by the Court, over such objection, to continue to serve the company

and to dominate its affairs, the District Court holding (R. 22; 42 F. Supp. at 983):

> "I am of the opinion that the fact that certain of these directors may have violated the law in serving as such directors (at the September 17th and October 3rd meetings) would not render their acts as directors invalid."

We submit, the District Court, when so requested, under Section 191, on Oct. 1, 1941, to give these persons so enjoined permission to hold a corporate meeting on Oct. 3, 1941, and re-elect themselves officers and directors, and ratify their invalid action in filing the instant petition, was without authority to permit them to violate Section 9(a), and then to hold their acts in violation of that section, valid.

Their acts in respect to bringing the original invalid petition and their acts in respect to the purported corporate meetings attempting to validate the original filing of the petition, speak more clearly than words as to the honesty of their intentions. The fact that due to the vigilance of the State officials they were prevented from carrying out their plan (R. 162) does not mitigate or excuse their lack of "good faith" in the filing of their original petition.

The District Court's opinion (R. 23) (42 F. Supp. 983) that "there could be no valid action on the part of the directors of the Debtor without the participation of at least some of these allegedly disqualified persons" overlooks the fact that had the equitable and actual owners of this stock ever been permitted to vote it, they could have elected qualified directors who could validly have acted.

We must also respectfully disagree with the District Court's statement (R. 27), to the effect that the fact "the

stockholders of the Debtor had no interest in the assets is immaterial," and submit that such fact was of vital concern to the Court. *Case* v. *Los Angeles, supra.*

It is therefore respectfully submitted that there was a lack of "good faith" as that term is ordinarily and equitably used, and apart from its statutory definition in Section 146, in the filing of the original petition, by reason of which it should have been dismissed.

THE FORMER DIRECTORS, UPON INSOLVENCY, BECAME TRUSTEES OF FIDELITY'S ASSETS FOR THE BENEFIT OF THE CREDITORS, THE CONTRACT HOLDERS

Further substantiating that the directors did not act in "good faith" and that their corporate meetings were invalid, we must further consider the District Court's statement (R. 33-34) (42 F. Supp. at 988) that

> "The fact that some stockholder or director may have been motivated by the hope that he might preserve for the future some connection with the affairs of the company is not in itself proof of bad faith."

and disagree therewith.

By June 3rd the directors knew Fidelity was insolvent, and so stated in the petition filed June 6th (R. 30). In West Virginia, the cases hold that directors of insolvent corporations are trustees of its assets for the benefit of creditors:

> *Pyles* v. *Riverside Furniture Co.*, 30 W. Va. 123, 2 S. E. 909;
>
> *Arnold* v. *Knapp*, 75 W. Va. 804, 84 S. E. 895;

and in Virginia:

> *Triplett* v. *Fauver*, 103 Va. 123, 48 S. E. 875.

Therefore, it was general lack of "good faith" and violation of the equitable "clean hands" doctrine for the directors to do anything which was, or the purpose of which was, for the individual benefit of those directors who were acting as such trustees.[8]

A vote by a director, where he is personally interested, renders the transaction *prima facie* void.

> *Ravenswood Railway Co.* v. *Woodyard*, 46 W. Va. 558, 33 S. E. 285.

> "No member of a board of directors shall vote on a question in which he is interested * * * or be present at the board while the same is being considered * * *."
>
> Code of W. Va., Sec. 69, Art. 1, Ch. 31.

The reason for denying such interested director the right to vote is because of his fiduciary or trust relationship to the corporation.

> *Thurmond* v. *Paragon Colliery Co.*, 82 W. Va. 49, 95 S. E. 816.

A corporation is entitled to have the unbiased and uninfluenced opinion of each of its directors.

> *Tri-State Coal, etc., Asso.* v. *Neace*, 92 W. Va. 196, 114 S. E. 569.

A resolution of a board of directors in which one of their members was personally interested, passed at a meeting whereat that member's presence was necessary in order that a quorum be had, and the member voting in

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8 It is, of course, acknowledged that directors of an insolvent corporation, who act with honesty of intention and purpose, may authorize the filing of a petition under Chapter X.

favor thereof, the resolution is *prima facie* fraud and void.

*Sweeney* v. *Sugar Refining Co.*, 30 W. Va. 443, 4 S. E. 431.

*Flanagan* v. *Flanagan Coal Co.*, 77 W. Va. 757, 88 S. E. 897.

Hence, Debtor's petition was not filed in "good faith" and the decision ordering it dismissed was correct.

B

**Petition Not Filed in "Good Faith" as Defined in Section 146(4)**

Section 146(4), Chapter X, provides that the petition shall not be deemed to be filed in "good faith" if "a prior proceeding is pending in any court and it appears that the interests of creditors and stockholders would be best subserved in such prior proceeding."

Since the stockholders had no legitimate interest or equity remaining, the question arises, are the interests of the contract holders best subserved in the proceedings in the States, particularly the State Court in West Virginia, or in the Federal proceedings? This is a fair question and will be met squarely.

Petitioners' brief speaks of the possibility of rehabilitation. In substance, the District Court held liquidation was inevitable, albeit, a slow and orderly one (R. 30, 31). The Circuit Court of Appeals held there was an "immediate need of a liquidation" (R. 383). Counsel for Securities and Exchange Commission, in argument before the Circuit Court of Appeals, was compelled to admit that as a practical matter rehabilitation was an impossibility, and liquidation must ensue.

All testimony to the contrary was by the former officials, subject to being struck for unqualifiedness (T. 3469, 3692), and was pre-Pearl Harbor. Our government now needs the money formerly invested in contracts such as these, to be invested in War Bonds, which are not only a safer investment, but return a higher yield.[9]

Basically, there is only one real issue involved in these entire proceedings, and that question is, *WHO SHALL LIQUIDATE THE SECURITIES HELD IN EACH OF THE THIRTEEN DEPOSITORY STATES, AND WHO SHALL DISTRIBUTE TO THE CONTRACT HOLDERS THE FUNDS RECEIVED FROM THE LIQUIDATION OF THOSE SECURITIES?*

On the one side are these respondents, together with the other depository States and their officials, and on the other side is the Federal Trustee, together with some of the former officers and minority stockholders of the Debtor.

Thus, the subordinate question, is not an immediate liquidation of the assets for the best interests of the contract holders? The States so contend, and are ready to do it. (R. 406, 411, 412.) The opposition contended before the Circuit Court of Appeals, liquidation should be performed slowly and orderly over a five to ten year period. The Circuit Court of Appeals, with the entire record before it, and having twice before,[10] not including informal and preliminary hearings, having had the affairs of this company before it for consideration, one of which cases was an application for receivership on the grounds of insolvency,[10] held with the States that there was "immediate need for liquidation of the company's assets for

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9 See note to C. C. A. Opinion, 324, quoting from S. E. C. Report (Exh. 6 and 12), p. 113.

10 *Hutchinson* v. *Fidelity Investment Assn.*, 106 F. (2d) 431, and *Sims* v. *Central Trust Co.*, 123 F. (2d) 89.

the benefit of contract holders" (R. 383), and their interests would be best subserved in the prior State proceedings then pending in the State Court in West Virginia (R. 386).

The opinion of the Circuit Court of Appeals sets forth in a footnote (R. 365) the fifteen States having a deposit made by Debtor, the amount of that deposit and its legal nature in each of those States, and the statute of each of those States under which the deposit was made.[11] Actually, however, there are only thirteen true depository States.[12] In each of these thirteen States there is an actual deposit of securities held by the State, or some of-

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11 The Securities and Exchange Commission, pursuant to Section 30 of the Public Utilities Holding Company Act of 1935 (R. 366), made an investigation of "Investment Trusts and Investment Companies," which was from time to time printed and submitted to Congress in correlated parts; this particular Debtor was one of those companies investigated and reported on (R. 384), beginning in June, 1938, there being at least six such partial reports. Exhibits 6 and 12 of the case at bar dealt especially with the instant company (R. 130, 384). In Appendix W thereof, at pages 179-196, there is set out a brief summary of the laws of the various States showing their requirements for deposits, the statutory official placed by law in charge of such companies, and many of the regulations and safeguards placed by the States around the sale of contracts of this nature, and around the continuation of safeguarding the interests of the investing public in such companies.

12 Briefly, in Virginia the State Corporation Commission, acting under Section 5 of the Virginia Securities Law, required Fidelity to post a bond, payable to the Commonwealth, the conditions of the bond being set out in Section 5(r), which was to protect against selling claims, and was not a depository bond in any sense of the word. In lieu of surety on the bond, the State accepted $25,000.00 in government bonds which has been loosely, but incorrectly, referred to as a deposit in Virginia.

Pennsylvania required a $100,000.00 deposit as a prerequisite to doing business in that State, and later required protection for a certain few of the contract holders. These funds are in the nature of a true deposit, and were held by the State Banking Commission. However, immediately after the West Virginia State Court receivership was instituted, and prior to these Federal proceedings, equity receiverships were set up in both the Eastern and Western Districts of Pennsylvania, both of which are still in existence; the Western District receivership having approximately $10,000.00 in its possession, and the Eastern District receivership, by virtue of an order of that Court, took from the State Banking Commission in the Middle District of Pennsylvania all of the funds in its possession, approximately $232,000.00; and has since retained them, so that in Pennsylvania there is in actuality no deposit with the State or any official thereof.

ficial thereof, in the amounts as set forth in the opinion below (R. 366), each of which deposits is still retained by the depository State (R. 371).[13] There are *less than five per cent.* of the Debtor's former assets, *which are not held* by the depository States; that is, the *States hold over ninety-five per cent.* of all assets.

Let us now examine the reasons underlying the decision of the Circuit Court of Appeals.

On the side of the States, first, these thirteen States, beginning with West Virginia, in 1911, through their legislators, were sufficiently interested in their own people, and in the investments which those people made, to pass regulating laws for companies such as Fidelity, and were sufficiently interested in the protection of their people to require Fidelity and others to make a deposit with that State, or some official thereof, which was to protect, fully in most cases, the investors in that State in case Fidelity failed and became insolvent. The record shows these officials performed their required duties.

On the other hand, the Federal Government took no interest in these companies such as Fidelity until in 1935 the Securities and Exchange Commission was required, under the salutary laws passed concerning that body by Congress, to investigate these companies, report to Congress thereon, and recommend legislation therefor (R. 366). This the Securities and Exchange Commission fully and ably did, and among those laws passed was the

13 The West Virginia Receivers took into their possession undeposited securities and cash located in West Virginia, which, including escrow payments made by contract holders, amount to somewhat less than one million dollars. This, by order of the District Court, and over objection and protest of those State Court Receivers, was required to be turned over to the Central Trust Company, Trustee, in whose possession it has since remained (R. 371). There is still a deposit with the State of West Virginia, under the control of Auditor Sims, of more than $10,000,000 which was never turned over to the Federal authorities.

Investment Company Act of 1940, to take effect January 1, 1941.

But this Act was to apply for the future as to those companies and was not particularly concerned with the past, and *specifically* was not to disturb the deposits already made in the various States, but only such deposits as were made after the effective date of January 1, 1941 (R. 229). No deposit was made in any State by Fidelity after that date.

When it became apparent that the Debtor could not continue as a going insurance company, Mr. Sims, the Auditor of West Virginia, on March 25, 1941, advised the company, by a written letter (R. 139) that he was giving serious consideration to asking State Court statutory receivership for them, and asked them, however, to investigate the possibility of the company being placed in Federal Court under the Federal Bankruptcy Act for the purpose of determining whether it could be reorganized under that Act.

After a full and free discussion of the matter in a two-day session of the board of directors, a unanimous expression in favor of State Court proceedings was adopted,[14] and the Debtor was represented in those State Court proceedings thereafter instituted by the Auditor and made no objection thereto.

Until Mr. Fleming took the position that the Federal Court should take jurisdiction, some weeks after the State Court proceedings were instituted, no one else ever took that position (T. 3608).

After Auditor Sims instituted his statutory proceedings on April 11, 1941, in West Virginia, he advised the

14 See Exh. Minutes of Board of Directors' Meetings, Apr. 7-8, 1941, pp. 173-4; see also T. 2592-97, 2605-06, Testimony of F. s. Risley, Pres. of Debtor; T. 2774-76, 2228-29, Testimony of Tom B. Foulk, Atty. for Debtor.

other depository States of his action, and protective proceedings were instituted by State officials in other States.

In West Virginia two Receivers, respondents herein, were appointed. In the less than two months they were permitted to act, they made a list of all of the contract holders, together with all necessary data concerning each contract, including the amount due under each contract less any loan values thereon, and segregated by states; a complete and accurate account of all of the assets and funds of Fidelity, including the amount of each State deposit; notified the contract holders of the proceedings; kept in touch with the other States' officials and their proceedings; and had a nebulous plan beginning to form for voluntary reorganization.

On the other hand, the Federal Trustee has done nothing constructive since it was appointed except to hold the funds taken over by the District Court's order from the West Virginia Receivers, and to aid the Debtor in this controversy to retain the Federal Court jurisdiction. A partial report under Section 167 was filed. It contained only data previously prepared for the State Court receivership. Lists of creditors and assets of the company were filed, taken verbatim from the State Court receivership files by one of those State Receivers, who was and is now employed by the Trustee to manage the home office of Fidelity in Wheeling. Just a year ago the Trustee was ordered to have completed, by the District Court, its Sec. 167 report and to file it and as yet this has not been done. The respondents, on many occasions, have demanded its completion, and on just as many occasions were told by the District Court that it did not concern them, and the Trustee would file it when it was ready.[15] It has not yet been filed.

15. Particularly written motions by the Tennessee and West Virginia State Court Respondents, and orders thereon, included in the record sent the C. C. A.; not found in the printed record for this Court.

True, Auditor Sims of West Virginia originally desired and hoped to reorganize Fidelity, and the State Court Receivers were working towards that end. They attempted to get the Federal Court suit dismissed as quickly as possible, knowing that delay in reorganization proceedings is fatal. It has been. Fidelity is now as dead as the Pharaohs of Egypt. These respondents have so said, and still so say, ever since it became apparent that this was to be a lengthy controversy.

From the time the Federal proceedings were instituted, these respondents requested of the Debtor, and demanded of the Trustee, that a plan be filed, or any ideas of a plan, if any they had, as quickly as could be done. To date there has not been filed by the Federal Trustee or the Debtor one scrap of paper giving any indication of any possible, let alone probable, plan. Petitioners' brief herein gives no further or better information in that regard.

As the Circuit Court of Appeals said (R. 385):

> "Certainly it would be unjust and unreasonable to delay satisfaction of their (contract holders) claims in order that an illusory hope of reorganization may be entertained."

Next arises the subordinate question as to how the depository laws in the various States can best be interpreted. The position of the respondents and the other depository States is that each State can best interpret its own depository laws, and distribute the funds to the contract holders in that State entitled thereto, and any balances remaining they have definitely agreed to turn over to West Virginia, and should their contract holders not be paid in full, to look to the West Virginia fund for any balance due.

Those advocating Federal jurisdiction maintain that the District Court for the Southern District of West Virginia can better interpret the depository laws of each of the fifteen States than can the Courts of those States; that as well there are myriad problems of law to be settled in that Court which will take years of protracted litigation to decide. These problems are such as the "Series Trust Fund" theory, "Company Interfund Loans", "Geographical Location" ideas, "Change of Residence by Contract Holders", "Trust Fund Under State Line" theory, "Jackpotting all of the Funds Generally", "Jackpotting Under Geographical Lines", "Jackpotting Under Series", and such other legal theories. (Petitioners' brief, p. 42-43.)

The States refuse to recognize any such theoretical legal problems. Their statutes to them are plain that the deposit was made in each State for the benefit and protection of the contract holders of that State, and that those persons, and those only, are entitled to those funds, and the Circuit Court of Appeals, certainly a most competent and, particularly about the affairs of the instant company, a very informed Court, so held.

A brief reading of the State statutes, or even the brief quotations therefrom contained in the note to the Circuit Court of Appeals opinion (R. 365) will resolve all legal doubts.

*The petitioners say that they are not "to answer or resolve these questions" they raise "they are suggestions demonstrating the necessity of withholding any distribution"* (Petitioner's Brief, p. 44); on the contrary, the *STATES CAN, HAVE AND WILL ANSWER AND RESOLVE THESE QUESTIONS,* and in the majority

of instances have already done so. Red tape can, has been and will be cut to pieces.[16]

These respondents and the other depository States tend to the practical side of the law rather than the theoretical. With the exception of Pennsylvania and Virginia, whose position has been above and below explained, of the thirteen remaining depository States, six are respondents here. The other seven have advised counsel preparing this brief that they are in thorough accord with the position of these respondents and that, if it is possible so to do, they will so state in opposition briefs to be filed amicus curiae. In other words, all thirteen depository States are in perfect and harmonious agreement in opposition to those advocating Federal jurisdiction.

The Record (pp. 406-413, inclusive) contains letters to and from these respondents. Within thirty days from the handing down of the decision by the Circuit Court of Appeals, every one of the fifteen depository States, including Pennsylvania and Virginia, through their proper State officials, met in Charleston, West Virginia, July 9-11, 1942, and amicably discussed and *settled* their mutual problems. Each State, cooperating with each of the other States and the officials thereof, and with committees appointed therefor, will liquidate and distribute its own deposited fund to those rightfully entitled thereto. The quotation from the West Virginia letter (R. 406-7) and again (R. 410), the quotation from the Mary-

16 As stated so ably recently by Assistant Solicitor General Oscar Cox, "Boldness and imagination rather than dependence on archaic legalism" must govern the action of lawyers in War times. The responsibility of lawyers is to find affirmative ways by which decisions of policy makers can be promptly fulfilled. * * * "Intelligent inquiry will prompt many a lawyer to say 'Yes' or 'Go ahead' where traditional conservatism has always dictated 'Stop' or 'Caution'. Our lawyers must be sufficiently bold and imaginative to explore this new realm of freedom—to discover what the law *can do* as well as what it can prohibit."

land letter (R. 411-12), the quotation from the Iowa letter (R. 412-13) show clearly how the States have, can and will cooperate together.[17]

Thus, the question of liquidation has already been settled by and between the States.

A committee was formed which has prepared uniform proofs of claims for each of the depositor States and as well for Pennsylvania and Virginia, and a form for claims over against the West Virginia fund. Some of that group later met counsel for the petitioners, when a stay of mandate was requested of the Circuit Court of Appeals, and that group, as a condition to the stay, obtained a consent order, dated July 22, 1942, modifying the District Court's order of August 9, 1941, so as to permit the proper officials of the depository States the right to service those deposited funds and to permit them to send out and receive proofs of claims, and to perform other administrative functions looking towards a future distribution of the estate.

Since then they have proceeded to service those funds, collect interest thereon, sell some of the more risky securities, and put uninvested cash into interest bearing United States Government securities.

Not only has a uniform proof of claim been prepared, but it has been agreed to and adopted by each of the de-

17. The West Virginia letter (R. 410) shows the agreement that sales of securities would not be made, pending the decision of this Court, merely for the purpose of liquidation, but only for other good and sufficient reasons. The Maryland letter (R. 412), stating that they "expect to work out *mutually satisfactory arrangements with other interested State officials* to dispose of the securities as advantageously as possible"; the Iowa letter, showing that individual liquidation would not be had until it was determined by a committee appointed by that conference group, whether it would not be more advantageous to sell the assets as a whole; further statement from the Iowa letter: "Iowa, as agreed at the conference, does not intend to step out of bounds on the liquidation, but will go along with the rest of the States *in order that the best interests of all may be obtained.*"

pository States, and distributed to the officials of those States. At the time this opposition brief is being written, the administrative machinery in every single one of the depository States is in action, either preparing to, or already having sent out a proof of claim to each contract holder in that State; West Virginia sending out proofs of claim to all State contract holders having no deposit in their own State, but who, under the laws of West Virginia, will look to the West Virginia fund for their protection. This, by agreement between officials, includes Virginia. Each of the depository States, as well as sending and receiving a proof of claim against their own State deposit, will forward to the contract holders and receive from them a proof of claim for any deficiency in that State fund which will necessitate a claim over against the West Virginia fund.[18] The *State officials* will collect all of these claims over against the West Virginia fund and they will be turned over en masse to the West Virginia officials, who will accept them, file them, and consider them as pro rata claims against the West Virginia fund.

Thus, the theoretical ideas of Petitioner that the contract holders will "*be required to file claims in the courts of many States*" (Petitioners' Brief p. 43), has been overruled by the practical applications of law by the States, as set out above, and other than those whose claims disagree with that which is shown on the books of the Debtor company, no contract holder will be required to do anything other than sign his name, under oath, to not more than two proofs of claim, one against his own State fund and the other against the West Virginia fund for any deficiency in his own State fund, and return those in one

18 The Attorney General and the Banking Commissioner of Pennsylvania are working cooperatively with West Virginia officials to work out the situation in Pennsylvania, which will shortly be accomplished.

stamped self-addressed envelope, *to the statutory official in his own State.* Perhaps the simpleness of this plan has confused those in opposition to the States' position.

By the time this case is before this Court this matter will in all probability have been finished. So much for the impossibility of the States being able to perform that function.

There will be none of the fanciful and theoretical legal questions in the State proceedings which Petitioners claim to be necessary for the settlement of this estate (Petitioners' Brief p. 42-43). If at any time the legal interests of two or more States are, or appear to be, in conflict, agreements at the Charleston conference were entered into as to who the parties shall be, that their representation shall be by State officials, and the proper authorized legal forums have been selected. By declaratory judgments, advancement of the case for hearing and other rapid means of legal determination, these administrative problems will be submitted to the proper State Court, both sides being represented amicably, but earnestly, by their proper State officials, and a decision as to the legal rights involved will be promptly obtained and followed. We believe that the State Court in the State wherein such legal determination is necessary is better able to decide on the law of that State, and this being so for each of the fifteen States, than can one Federal Judge in Southern District of West Virginia, however learned he may be.[19] So did the Circuit Court of Appeals. (R. 386.)

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19 Since the States have possession of the deposited securities and claim title to them, and in most instances have title, it may well be that should Federal jurisdiction be upheld, there would have to be brought by the Federal Trustee fifteen plenary suits in fifteen States, to attempt to recover possession of the deposited securities, thus adding to the perplexity of undecidable questions in Federal proceedings.

Thus, in less than thirty days from the handing down of the decision, a meeting (Charleston, W. Va., July 9-11) was held and matters settled and determined, and within two months, these State officials have proceeded with and performed that which the Federal Trustee, in fifteen months, is still studying about and wondering how to do, and which the Petitioners say cannot be done. In Federal Court there has as yet been no move made to have claims proved, or other than theoretical plans laid down as to how it shall be done.

Let us now look at the personnel of each side. In each State the deposited securities were under the custody and control of an official of that State. In most of the States the Attorney General has acted in the State proceedings as the official representative of that State officer (West Virginia, Illinois, Wisconsin, Delaware, Alabama, Kentucky, Pennsylvania, Virginia, Ohio, Indiana, Maryland), and in the others has acted in an advisory capacity (Iowa, Kansas, Missouri, Tennessee).

In most of the States statutory actions have been instituted in proper State Courts, and the officials of those States are acting under the judicial guidance of those State Courts.

These respondents, although widely separated geographically, have worked amicably, interestedly, and purposefully together. They have divided the onerous duties of this litigation among themselves, some acting in Court as trial examiners, others making a research of the law and cases, others preparing motions, briefs, and other legal papers; they prepared and carried out successfully a joint and several appeal to the Circuit Court of Appeals; they briefed the matter separately, some States acting jointly, but by agreement legal points were apportioned among the various States, and their individual

efforts, without duplication, presented one joint brief in a united front. They are again attempting to do that in this Honorable Court.

This is the practical and working answer of the States to those opposed to them, who have contended that the States cannot and will not work together, and that it is necessary to have one central authority or control of the entire matter, that one to be a District Court, for all problems of law, and the other a private trust company and its attorneys, for the remaining matters.

In answer to the District Court's opinion in the *National Surety* case (Petitioners' Brief p. 45) in which he regretted being unable to exercise his salutary jurisdiction over the reorganization of that company, need it be said that that company, acting under State Insurance Commissioners and State Courts, has been successfully reorganized, and done so in a far less time than the five to ten years claimed needed here.

Some judges seem surprised to learn that there have been a large number of insurance companies in the United States reorganized successfully and as going concerns, and others liquidated successfully, and that every single one of these, without exception, has been done under the supervision and jurisdiction of the State statutory officials and the State Courts, either in a single State or in many States, acting jointly and cooperatively together. The experience of these States stands them in good stead in solving problems such as the instant one, and we submit they have demonstrated that experience by their actions to date.

On the other side, we have a private trust company with no experience in these matters, which is limited to trust work only and not even to the banking business. True, it has employed one of the West Virginia Receivers to head

its home office there, has hired and kept on its payroll "financial advisors" and "investment counsel", and has had capable counsel appointed by the Federal Court for it, yet who still consults private counsel, and whose private counsel are now the Debtor's attorneys presenting this petition. It applied for an interim allowance of $22,500.00 as part payment for nine months' labor of holding and servicing less than one million dollars, at least fifty per cent of which is cash. All other expense, including the "experts" it hired, even to the filing clerks of its own company, have been paid from the funds of the contract holders in its possession, by virtue of orders of the District Court. The hearing had on these fees was after argument of the case to the Circuit Court of Appeals, and the Trustee was paid during that period, before the decision was rendered, the sum of $18,000.00 as interim allowance as part payment for this work, over objection of these respondents. True it is that the Trust Company, although supposedly a disinterested trustee, has entered this litigation and has attempted to sustain Debtor's petition and the jurisdiction of that Court which appointed it, and filed a brief in the Circuit Court of Appeals, and is now joining as a party to the presentation of this petition.

Therefore, it is respectfully submitted that not only can the contract holders' interests best be subserved by continuation of the proceedings in the States, but that they, by their actions and work, have rendered moot all of the supposedly difficult Federal questions raised in Debtor's petition. By practical application of the law by these experienced State administrators, they have performed everything which need be done in these proceedings except sell the securities and distribute the funds. They are prepared at the present time, and have offers of purchase for all or various parts of the deposited securities

which can be accepted immediately. There will then be left only the task of distribution, which will be accomplished just as rapidly as possible, and in conformity with the speed with which they have acted in the other matters where they have been permitted so to do.

It is therefore urgently requested that this Court as quickly as possible dismiss the petition and allow these respondents, and the other States associated with them, to distribute the money as quickly as possible to the 87,999 contract holders, to whom it belongs and *who so earnestly desire it*, and who eagerly await the decision of this Honorable Court permitting them to obtain it.

## C

## Debtor's Petition Was Never Validly Filed or Ratified and Could Not Have Been Validly Ratified

As to the three purported meetings of the Debtor or its directors (June 3, September 17, and October 3, 1941), that of June 3rd was invalid and was properly so held by the District Court (R. 21; 42 F. Supp. at 983).

It was necessary for the directors to have a lawful and valid corporate meeting to authorize or ratify filing the petition, and that which a majority of them, acting in an invalid corporate meeting or acting in their individual capacity, did is not legally binding. They could act only as a body, their power not being joint and several in West Virginia, only joint.

*McRealty Co.* v. *Beckley Hardware Co.*, 107 W. Va. 290, 291, 148 S. E. 122.

*Pennsylvania Line Road Co.* v. *Board*, 23 W. Va. 360.

*Craft* v. *Blackwater Boom, etc., Co.*, 46 W. Va. 56, 64, 33 S. E. 125.

*Lawrence* v. *Montgomery Gas Co.*, 88 W. Va. 352, 357, 106 S. E. 890.

Fleming was clearly not entitled to participate in the Pittsburgh meeting because, even though a person may be elected a director, before he can perform any such duties, where a stock holding is a requirement, he must qualify by becoming a stockholder.

*Triplex Shoe Co.* v. *Rice*, 17 Del. Ch. 356, 152 Atl. 342, at 351.

Where a board of directors consists of nine members and two resign, four members do not constitute a quorum to fill vacancies. The law requires a majority to transact business.

*Mecleary* v. *Mecleary, Inc.*, 13 Del. Ch. 329, 119 Atl. 557.

Where by-laws provide the board of directors shall consist of seven, a majority to constitute a quorum, the vote of three directors is not a quorum where there exist four vacancies.

*Bruch* v. *National Guarantee Credit Corp.*, 13 Del. Ch. 180, 116 Atl. 738.

The meeting of September 17th was equally invalid, and it is submitted that even Mr. Ray, Debtor's attorney, so recognized this in seeking permission for the meeting of October 3rd, and actually abandoned any contention as to its validity (T. 2261, 2263). The District Court sustained the validity of the September 17th meeting on the ground that one who, without his knowledge or consent,

is elected a director, and who thereafter immediately, in writing, refuses to accept the position, is nevertheless a director until his "resignation" is accepted by the board that elected him. That this proposition is fundamentally unsound is so apparent as not to require citation of but a few of many authorities.

13 A. J. 858, Sec. 87; 868, Sec. 885; 867, Sec. 883.

Fletcher on Corporations 71, Sec. 314.

*Briggs* v. *Spaulding*, 141 U. S. 132, 35 L. Ed. 662.

*West Leechburg Steel Co.* v. *Smitton*, 280 Mich. 180, 273 N. W. 439.

The District Court held that the unauthorized filing of a petition by officers of a debtor under Chapter X was an act that could be ratified (R. 23) (42 F. Supp. 984). It is submitted that that action is so serious that ratification should never be permitted; also, ratification of a previously unauthorized act by a director then beneficially interested, would stand on no higher plane than the original act.

*Thompson* v. *Laboring Man's Mercantile Co.*, 60 W. Va. 42, 53 S. E. 908.

The law appears plain that there is no presumptive authority in any officer to file such a petition without special authority therefor.

Gerdes on Corporate Reorganization, Volume I, Section III, pages 264, 265, states:

> "There is no presumption that any officer of a corporation, even its President, has power to authorize the filing of a voluntary petition in bankruptcy. The filing of such a petition is not part of the ordinary conduct of the business of the cor-

poration and therefore requires special action by its board of directors or its stockholders, unless an officer is given express authority for that purpose in the corporate by-laws or certificate of incorporation."

*In re Jefferson Casket Co.* (D. C. Ky.), 162 F. 689.

*In re Community Book Co.* (D. C. Minn.), 10 F. (2d) 661.

*Regal Cleaners & Dyers* v. *Merlis* (C. C. A. 2d), 274 F. 915.

Any such unauthorized filing of a petition purportedly on behalf of a debtor will result in its dismissal.

*In re Joseph Feld & Co.* (1941), 38 F. Supp. 506.

The objections which were made in the District Court to the validity of the meeting of October 3rd, to-wit, that the District Court could not under Section 191 of Chapter X give permission for a violation of Section 9(a) of the Investment Company Act of 1940; that the majority of those requested to be elected directors and officers were subject to that injunctive order in the Securities and Exchange Commission suit in Detroit in 1938; that the Court refused to permit the equitable owners of the stock to vote it; that no listing was made of the stock represented by the stockholders present (T. 3000); that the Court rejected the suggestion that a disinterested person be present at those meetings (T. 2281); that John Marshall, as trustee, in violation of the state laws of West Virginia (Code 31-1-73) and in violation of all equity and fair play, voted 9570 shares out of 9887 shares to ratify his own acts and activities; and that those elected to the board of directors were his relatives and others subject to his own bidding, is sufficient, we submit, to sustain

the proposition, without further argument, that there was no valid and legal corporate meetings; and thus never any valid ratification of the invalid meeting of June 3, 1941, and consequently there has never been any valid corporate authority for the filing of Debtor's petition in these proceedings.

## II

## PETITIONERS CANNOT RIGHTFULLY FILE PETITION FOR WRIT OF CERTIORARI

### A

### Trustee Has No Right to File Petition

Section 156 of Chapter X provides that the Trustee appointed shall be disinterested.

Section 158(4) provides that such a person shall not be deemed disinterested if it appears that he has, by reason of any direct or indirect relationship to, connection with, or interest in the Debtor, an interest materially adverse to the interests of any class of creditors. There is only one class of creditors in this case, that is the contract holders.

Throughout the hearings of the District Court, the Trustee's appointed attorneys engaged in that jurisdictional controversy on the side of the Debtor, undertook to sustain the Debtor's petition and the jurisdiction of the District Court, over numerous objections and exceptions of these respondents, that is the depository States and the contract holders. (T. 3620, 3625, 3634, 3642, 3644.)

The Trustee, through its appointed attorneys, filed a brief in the Circuit Court of Appeals attempting to sustain Debtor's position, and in opposition to that of these respondents. The West Virginia appellants therein chal-

lenged the right of the Trustee and its attorneys to appear on behalf of the Debtor, and their right to attempt to sustain Debtor's petition and the jurisdiction of the District Court, and moved to strike that brief from the proceedings (R. 358). This motion was not acted upon by the Circuit Court of Appeals.

It is undisputed that Mr. Ray and Mr. Holt, the capable attorneys now representing Debtor, each belong to a firm of attorneys each of which is general counsel for Central Trust Company, the Trustee herein.

Therefore, it is submitted that the Trustee has, in violation of the provisions of Chapter X, not been disinterested; has been interested in the Debtor, both directly and indirectly; and has shown, and is showing, an interest adverse to the contract holders, the true creditors herein.

The only decided case on this question holds that the Trustee has no right, in circumstances such as these, to apply for writ of certiorari.

*Loomis* v. *Gila County*, 103 F. (2d) 312, Certiorari denied, 307 U. S. 643.

"The trustee is not concerned with the merits of the petition under Section 77B or its dismissal."

And its appeal from a dismissal of a debtor's petition was refused.

Therefore, the Trustee is not a proper party to the petition for writ of certiorari in the case at bar.

B

**Those Purporting To Act for Debtor Have No Right to File Instant Petition**

INTEREST OF DEBTOR IN THE APPLICATION FOR WRIT OF CERTIORARI

Other than as set forth herein above, there has been no corporate authorization by the Debtor for filing the

petition for writ of certiorari, nor for attorneys to appear in its behalf, and no corporate authority for its present attorneys to act in its behalf or to represent it. Apparently John Marshall, acting under the resolution which he himself passed by virtue of the stock trusteed in him, is employing attorneys and spending money belonging to the contract holders in carrying on this vain and useless controversy.

Therefore, there having been no valid meeting of the Debtor corporation before the petition was filed, and the act being such a one that it could not and should not be permitted to be ratified, and the attempts to ratify it being unlawful and invalid, the original petition was invalidly filed, the filing thereof was never validly ratified, and therefore the judgment rendered by the Circuit Court of Appeals should not be disturbed.

As set forth in the District Court's opinion, the Debtor is insolvent in a bankruptcy sense, in that on the basis of market values its liabilities exceed its assets by approximately ten per cent. (R. 30) (42 F. Supp., at 986).

Those stockholders who are attempting to continue this controversy, on the witness stand, stated emphatically not only that they had no new money themselves to invest in the company, but that for several years prior to the institution of these proceedings vigorous attempts had been undertaken to procure new capital, and every means tried was unavailing (R. 384).

For the stockholders to participate in any plan of reorganization under such facts as these, that participation must be based on a contribution in money or moneys worth. Mere management or agreement for further management is not sufficient. *Case* v. *Los Angeles, supra.*

In the case at bar, however, the District Court repeatedly reiterated that those who had formerly been the

managers of the company and been in control thereof would never be permitted by the Court in the future to participate in its management or its affairs.

> "To hold that in a 77B reorganization creditors of a hopelessly insolvent debtor may be forced to share the already insufficient assets with stockholders, because apart from rehabilitation under that section they would suffer a worse fate (liquidation), would disregard the standards of 'fair and equitable;' and would result in impairment of the Act to the extent that it restored some of the conditions which the Congress sought to ameliorate by that remedial legislation. * * * junior interests must be excluded unless they furnish adequate consideration for the interest which they obtain in the new company."
>
> *Case* v. *Los Angeles Lbr. Products Co., supra:*

Therefore, under the ruling of this Court in the *Los Angeles* case, these stockholders can never participate in any reorganization as under the rulings of the District Court and the Circuit Court of Appeals, they have no equity remaining.

It is therefore submitted that they have no legitimate interest in petitioning this Court for a writ of certiorari, using Debtor's name therefor, particularly as even under the apparent decision of the District Court the only possible future in Chapter X proceedings for Fidelity is a liquidation, even though slow and orderly.

### Stockholders' Plan to Obtain Contract Holders' Funds

We use the word "legitimate" above advisedly, because these respondents contend that these stockholders are motivated by unfair and inequitable reasons in attempting to retain the proceedings under Chapter X.

While both the Courts below have held there is no equity remaining for the stockholders, yet it is submitted that such is not their belief, and an examination of Chapter X discloses why the stockholders are so interested in retaining these proceedings, while paying lip service to the phrase "for the best interests of contract holders."

Section 204 of Chapter X provides that upon distribution, which should, of course, be a part of the District Court's stated idea of a slow and orderly liquidation, the judge may fix a time, not sooner than five years after closing the estate, after which no claimant or stockholder shall participate in distribution under the plan.

Evidence was offered, and we think it is a recognized fact, that of the 87,000 contract holders, a certain percentage would file no claim or would be impossible to locate. Should this number be even as low as twenty per cent, and should the rest be paid in full, of the approximately twenty million dollars of Fidelity's assets, this could leave four million undistributed.

If the Debtor were reorganized by way of rehabilitation, as these respondents insist is the only correct interpretation of Chapter X, this undistributed sum would be transferred to the rehabilitated corporation, and consequently to the benefit of the contract holders, the only true creditors.

Under the District Court's theory of slow liquidation, and not rehabilitation, under Section 205 of Chapter X, it is provided what would be done with this undistributed sum.

> "The securities or cash remaining unclaimed at the expiration of the time, as provided in Section 204 of this Act, or any evidence thereof, *shall become the property of the debtor* or of the corporation acquiring the assets of the debtor under the plan, as the case may be, free and clear of any and all claims and interest."

There is no exception made to this section, and since there would be no new corporation acquiring Debtor's assets under the plan of a slow and orderly liquidation, this sum of at least four million dollars would be RETURNED TO THE DEBTOR, which, in this case, means the STOCKHOLDERS.

It was earlier presumed that since the District Court had frequently reiterated throughout the hearings that the stockholders had no interest in the Debtor's assets, that the District Court would take means to prevent this occurrence from happening.

However, a decision by the District Court on June 11, 1942, in *Sanders* v. *Chandler*, U. S. D. C. E. Pa. (Moore, D. J.), 11 Law Weekly 2040 (being the same Judge who decided the case at bar in the District Court below, being assigned to Pennsylvania temporarily), leads to the inevitable conclusion that the result which the stockholders seek, that is, the escheat to them of the funds belonging to the contract holders, would be decided in their favor by that District Court.

In the *Sanders* case the District Court held, with reference to an insolvent National Bank, and a Pennsylvania statute providing for escheat to the State of unclaimed funds in the hands of such a receiver, that such statute is invalid.

The Court's reasons were that unclaimed funds were not actually such, "unless the total moneys in his (the Comptroller's) hands be more than enough to pay in full the creditors who have proved claims." Merely because some depositors failed to make a claim does not necessarily result in unclaimed funds, nor does it serve to earmark particular funds as property of such depositors.

> "All of the funds on deposit in the bank, other than those held in trust, belong to the bank, and

upon insolvency are to be distributed ratably by the Comptroller to the creditors who prove their claims under the law. Only in case a surplus exists after proven claims have been paid in full may a receiver for a National Bank be said to have unclaimed funds in his hands. As I have already pointed out, even this surplus *must* under the federal statutes be *distributed to the stockholders*. * * *"

The States who have these funds on deposit can hold them indefinitely for the contract holders. In any event, it is submitted that since the contract holders stand to suffer loss by virtue of any market or other depreciation of the deposited securities, that the deposited fund belongs entirely to the contract holders, and they should receive any appreciation in it, by any means whatsoever, and in no event should the stockholders be permitted to share in the deposited funds.

All of the costs and expenses of these proceedings under Chapter X, including all of the Debtor's expenses for summoning of witnesses, paying transportation therefor, paying of court costs, expenses of counsel, not including counsel fees, payment of costs of printing records and briefs, have been paid out of the funds in the hands of the Trustee which belong exclusively to, and should be for the benefit of, the contract holders alone.

Since it is apparent that the stockholders who are applying, in the Debtor's name, for the issuance of a writ of certiorari have no equitable interest in the Debtor's former assets, and are by the above indirect and subtle means attempting to accumulate for themselves in the future a really substantial sum of money which, as well, belongs solely to the contract holders, they should have no standing to file their petition in this Court.

And since these stockholders were the former directors of the Debtor, and as such trustees for its assets on insolvency for the benefit of the same contract holders, and since their purported corporate activities were in violation of their trust or fiduciary duties, and since their attempts to accumulate a fund for themselves in the future could not and would not happen in the event the State proceedings are continued, it is respectfully submitted that this Court should deny the petition for writ of certiorari and permit the judgment of the Circuit Court of Appeals dismissing the purported Debtor's petition filed in the case at bar to be carried into effect.

# ADDENDUM

There were certain other issues raised in the District Court (42 F. Supp. 981) by these respondents which were briefed and argued to the Circuit Court of Appeals (R. 363), which latter Court neither discussed nor decided these questions (R. 363), but which, it is submitted, were of such substantial intrinsic worth that they would support and uphold the correctness of the decision and judgment of the Circuit Court of Appeals in and of themselves.

III

Deposits of securities were required to be made by Fidelity by the laws of each of thirteen different States and such deposits were so made. These deposits were made either with the State itself or with an official of that State, usually as Trustee for the benefit of contract holders in that particular State. It is contended, especially where the deposit was made with the Sovereign State itself, as in West Virginia, the officials of those States, such as the West Virginia Auditor, who had possession, custody or control of those deposited funds, are protected from suit, order or the jurisdiction of the District Court by the Eleventh Amendment to the Constitution of the United States, and clothed with immunity thereby, so that they and the deposited funds were not subject to the jurisdiction of the District Court in these proceedings.

Under Code of West Virginia, Chapter 33, Article 9, Section 3, it was provided for the Insurance Commissioner to require a deposit with the State Treasurer from such companies as the Debtor, *"in accordance with Article 5, Chapter 12"* to be held in trust for the benefit

of contract holders for their security; and Section 2 of that latter article and chapter provides that the Treasurer of West Virginia "shall be the custodian of all securities belonging to the State of West Virginia *or required to be deposited with the State.*"

The various laws of the other States required deposits of securities to be made either with the State itself or with some official of the State, for the benefit and protection of the contract holders, and in many instances, with an actual transfer of title to the securities. In West Virginia, after Debtor's license was revoked or expired, which it admittedly did no later than April 4, 1941, the deposit was to "remain under the authority and control of the Insurance Commissioner", who is the Auditor (Code W. Va. 33-9-10).

By virtue of this section and by reason of the S. E. C. report (Exhibit 6 of the instant case) at page 124, Note 12[20] even the residual interest, if any[21], of the Debtor in the deposited securities, no longer remained on June 6, 1941, the date the petition was filed.

Therefore, these respondents have contended, and still contend that, by virtue of the Eleventh Amendment to the Constitution of the United States, the District Court had no jurisdiction over either the deposited funds or over that Sovereign State which required a deposit, or the State official who had custody and control and administrative charge thereof.

Restatement of the Law of Trusts, Sec. 95, p. 264[22].

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20 "In the collateral trust, face-amount certificate, the securities are pledged merely to secure the company's obligation, and the company has a *contingent right* in the securities so deposited and their earnings SO LONG AS ITS OBLIGATIONS ARE DISCHARGED."

21 On the basis of market values, Debtor has had no residual interest in the deposited funds in West Virginia for at least nine years (R. 383).

22 "The United States or a State has capacity to take and hold property in trust, but in the absence of a statute otherwise providing, the trust is unenforceable against the United States or a State."

*Lankford* v. *Platt Iron Works*, 235 U. S. 461, 59 L. Ed. 316.

*Farish* v. *State Banking Board*, 235 U. S. 498, 59 L. Ed. 330.

Numerous other cases and authorities were cited in support of this contention below, but which, in this brief in opposition, we feel need not now concern this Court.

## IV

The principal office of the Debtor was in the Northern District of West Virginia, and the only assets available to constitute "principal assets" of the Debtor within the territorial jurisdiction of the District Court for Southern West Virginia were the funds on deposit with the State of West Virginia. Since by virtue of Point I above (Eleventh Amendment), they were not subject to the jurisdiction of the Court, and since the Debtor did not even retain a residual interest in those funds, then the petition should have been dismissed because of improper venue.

These respondents submit that the term "principal assets" as used in Section 128 of Chapter X means only those assets capable of being taken into possession by the Trustee and susceptible of administration by it.

This is true because of the ancestry of Chapter X, derived from the federal equity receivership rules, as set forth in Finletter "The Law of Bankruptcy Reorganization", page 23. On pages 86 and 91, the author clearly sustains this contention of these respondents, and there being no other assets of the Debtor within the territorial jurisdiction of the District Court, clearly venue was improperly laid.

The District Court only has jurisdiction of the Debtor and "its property wherever located". Sec. 111 of Chapter X. But in West Virginia, Maryland, Iowa and many of the other depository States, legal title to the deposited securities was required to be, by their depository statute, and actually was, transferred to the depository State or proper official thereof. Equitable title, or beneficial interest, was by statute in the contract holders. As shown by the record, at least in the great majority of the depository States, there was not and had not for some years been any actual residual interest for the Debtor. Therefore, the Debtor was at the institution of these proceedings no more the owner of the deposited securities than is the settler of a conventional trust the owner of property transferred in trust by him.

*Warner* v. *Brady*, 115 F. (2d) 89.

Therefore, the District Court had no jurisdiction over such deposited securities.

## V

The State statutes regulating the Debtor and requiring deposits of its securities were enacted under the police power reserved to the States, and if Chapter X of the Bankruptcy Act were construed to grant to a Federal Court the power to enter a decree in conflict with such State statutes, it would violate the Tenth Amendment to the Constituion of the United States.

These State statutes provided in detail for the regulation of the business conducted by companies such as the Debtor, the most important of which was that requiring a deposit of securities to be held in trust for the benefit and protection of the contract holders, such deposit to be made with the State or some official thereof. Congress, under its bankruptcy powers, could not set aside State statutes

on matters of such important public policy without setting at naught the entire theory of State sovereignty; and because the powers of the Federal Government are by the Constitution always subject to the implied limitation that the rights of the Sovereign States reserved by them cannot be transgressed.

*Hopkins Federal Savings & Loan Asso.* v. *Cleary*, 296 U. S. 315.

*Ashton* v. *Cameron County District*, 298 U. S. 513.

VI

The delivery of securities by the Debtor under the depository laws of the various States constituted contracts in the public authority within the meaning of Chapter X of the Bankruptcy Act.

Section 116(1) of Chapter X provides that the Judge may permit rejection of executory contracts of the Debtor "*except contracts in public authority.*" These same quoted words are used in Section 216(4).

Respondents contend that these deposits did constitute such contracts made in the public authority, the Debtor having accepted the terms and provisions of these statutes, in order to be permitted to do business in each of the depository States, and that, therefore, the District Judge could not permit them to be rejected.

## CONCLUSION

It is respectfully submitted that the petitioners have shown no jurisdiction whereby the petition should be granted, and have shown no reasons, in law or fact, which would justify this Court in granting the petition, and that respondents have set forth many substantial grounds why the petition should be dismissed, and the urgency

therefor, it is respectfully submitted that the petition should be dismissed and the writ of certiorari should not be issued.

Respectfully submitted,

IRA J. PARTLOW,
*Assistant Attorney General of West Virginia,*

*Attorney for West Virginia*

W. S. WYSONG,
*Attorney General of West Virginia.*

KOONTZ & KOONTZ,
By: *J. Campbell Palmer, III,*
*Of Counsel for West Virginia*

# APPENDIX A

## Statutes Considered in this Brief

(Only pertinent parts are quoted)

### Federal Statutes

Section 4 of the Bankruptcy Act as amended by the Act of June 25, 1910, 36 Stt. 839, 11 U. S. C. A. 22:

> 22. *Bankrupts; who may become.* (a) Any person, except a municipal, railroad, insurance, or banking corporation, shall be entitled to the benefits of this title as a voluntary bankrupt.
>
> (b) Any natural person, except a wage earner or a person engaged chiefly in farming or the tillage of the soil, any unincorporated company, and any moneyed, business, or commercial corporation, except a municipal, railroad, insurance, or banking corporation, owing debts to the amount of $1,000 or over, may be adjudged an involuntary bankrupt upon default or an impartial trial, and shall be subject to the provisions and entitled to the benefits of this title.

Section 141, Chapter X of the Bankruptcy Act (11 U. S. C. A. 541):

> Upon the filing of a petition by a debtor, the judge shall enter an order approving the petition, if satisfied that it complies with the requirements of this chapter and has been filed in good faith, or dismissing it if not so satisfied.

Section 144, Chapter X of the Bankruptcy Act (11 U. S. C. A. 544):

> If an answer filed by any creditor, indenture trustee, or stockholder shall controvert any of the material allegations of the petition, the judge shall, as soon as may be, determine, without the intervention of a jury, the issues presented by the pleadings and enter an order approving the petition, if satisfied that it complies with the requirements of this chapter and has been filed in good faith and that the material allegations are sustained by the proofs, or dismissing it if not so satisfied.

Section 146 (3) and (4), Chapter X of the Bankruptcy Act (11 U. S. C. A. 546):

> Without limiting the generality of the meaning of the term "good faith", a petition shall be deemed not to be filed in good faith if—
>
> • • •
>
> (3) it is unreasonable to expect that a plan of reorganization can be effected; or
>
> (4) a prior proceeding is pending in any court and it appears that the interests of creditors and stockholders would be best subserved in such prior proceeding.

Section 150 of Chapter X of the Bankruptcy Act (11 U. S. C. A. 556):

> Upon the approval of a petition, the judge shall, if the indebtedness of a debtor, liquidated as to amount and not contingent as to liability, is $250,000 or over, appoint one or more trustees. Any trustee appointed under this chapter shall be disinterested and shall have the qualifications prescribed in section 73 of this title, except that the trustee need not reside or have his office within the district. • • •

Section 158(4), Chapter X of the Bankruptcy Act (11 U. S. C. A, 558):

> A person shall not be deemed disinterested, for the purposes of section 556 and section 557 of this title, if—
>
> • • •
>
> (4) it appears that he has, by reason of any other direct or indirect relationship to, connection with, or interest in the debtor or such underwriter, or for any reason an interest materially adverse to the interests of any class of creditors or stockholders.

Section 191, Chapter X of the Bankruptcy Act (11 U. S. C. A. 591):

> "• • • No person shall become an officer or director of the debtor, to fill a vacancy or otherwise, without the prior approval of the court."

Section 9(a) of the Investment Company Act of 1940 (15 U. S. C. A, Sec. 80a-9(a)):

> (a) It shall be unlawful for any of the following persons to serve or act in the capacity of officer, director, member of an advisory board, investment adviser, or depositor of any registered investment company, or principal underwriter for any registered open-end company, registered unit investment trust, or registered face-amount certificate company:
>
> • • •
>
> (2) any person who, by reason of any misconduct, is permanently or temporarily enjoined by order, judgment, or decree of any court of competent jurisdiction from acting as an underwriter, broker, dealer, or investment adviser, or as an affiliated person, salesman or employee

of any investment company, bank, or insurance company, or from engaging in or continuing any conduct or practice in connection with any such activity or in connection with the purchase or sale of any security;

• • •

(b) Any person who is ineligible, by reason of subsection (a), to serve or act in the capacities enumerated in that subsection, may file with the Commission an application for an exemption from the provisions of that subsection. The Commission shall by order grant such application, either unconditionally or on an appropriate temporary or other conditional basis, if it is established that the prohibitions of subsection (a), as applied to such person, are unduly or disproportionately severe or that the conduct of such person has been such as not to make it against the public interest or protection of investors to grant such application.

Section 111, Chapter X of the Bankruptcy Act (11 U. S. C. A. 511):

Where not inconsistent with the provisions of this chapter, the court in which a petition is filed shall, for the purposes of this chapter, have exclusive jurisdiction of the debtor and its property, wherever located.

Sec. 116(1), Chapter X of the Bankruptcy Act (11 U. S. C. A. 516):

Upon the approval of a petition, the judge may, in addition to the jurisdiction, powers, and duties hereinabove and elsewhere in this chapter conferred and imposed upon him and the court—

• • •

(1) permit the rejection of executory contracts of the debtor, except contracts in the public authority, upon notice to the parties to such contracts and to such other parties in interest as the judge may designate; * * *

Sec. 128, Chapter X of the Bankruptcy Act (11 U. S. C. A. 528):

If no bankruptcy proceeding is pending, an original petition may be filed with the court in whose territorial jurisdiction the corporation has had its principal place of business or its principal assets for the preceding six months or for a longer portion of the preceding six months than in any other jurisdiction.

Section 216(4), Chapter X of the Bankruptcy Act (11 U. S. C. A. 616):

A plan of reorganization under this chapter—

(4) may provide for the rejection of any executory contract except contracts in the public authority; * * *

Constitution of the United States:

Tenth Amendment:

The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people.

Eleventh Amendment:

The Judicial power of the United States shall not be construed to extend to any suit in law or equity, commenced or prosecuted against one of the United States by Citizens of another State, or by Citizens or Subjects of any Foreign State.

**West Virginia Statutes**

Code of West Virginia (Ch. ____, Art. ____, Sec.____):

31-1-73:

Any stock corporation of this State, except * * * insurance companies, may, by stipulation and grant of particular powers in its charter, authorize any two or more of its stockholders, by agreement in writing to be filed in the office of the corporation, to vest in some person, * * * as voting trustees, the exclusive right to vote the shares of stock of the parties to such agreement, upon all questions * * *."

12-5-2:

Treasurer Custodian of Securities.—The treasurer of this State, unless otherwise expressly provided by law, shall be custodian of all securities belonging to the State of West Virginia or by law required to be deposited with the State or held in legal custody by the State, and all departments of this State, commissioners or agents of the State, who hold any such securities, shall transfer and deliver the same to the state treasurer to be kept and held by him as legal custodian thereof until released in the manner provided by law.

12-5-6:

Whenever, by statute of this State, any public official, board, commission or department of this State is charged with the approval of securities required as collateral for the deposit of public or other funds, or required to be deposited with the state treasurer, or an investment of capital or surplus or a reserve or other fund, is required to be maintained consisting of designated securities deposited with the state treasurer, such securities shall, at the discretion of such public official, board, commission or department, be deemed to include

and mean notes executed by the person or corporation required to make such deposit *and made payable to the state of West Virginia upon demand,* in the event of insolvency or default by such person or corporation, for the benefit of those for whom such securities are deposited, * * *.

33-9-3:

Deposits to Be Made with the Treasurer.—Before a license to transact business in this State shall be issued by the insurance commissioner to any person, association, or corporation within the purview of section one (s. 3446) of this article, the insurance commissioner shall require the applicant to deposit with the state treasurer (in accordance with article five, chapter twelve of this code), in trust, for the benefit of its contract holders, bonds of the state of West Virginia, or such other bonds, and securities including bonds issued by the West Virginia bridge commission as may be approved by said insurance commissioner, or both, to the aggregate amount of one hundred thousand dollars, and, in addition to such deposit, such person, association or corporation shall maintain at all times a deposit with the state treasurer of bonds and securities approved by the insurance commissioner to an amount equal to the total amount which such person, association or corporation may be liable to pay in cash to the holders of all contracts under the terms thereof at the time of the deposit: Provided, That when, by the laws of any other state, any such person, association or corporation shall have been required to make and shall have made such deposit in such state, equal or greater in amount for the benefit of contract holders in such state, upon the filing of a certificate to such effect from the proper officer in such state with the insurance commissioner of this State, such person, association or corporation shall not be required to

make such deposit with the treasurer of this State for the benefit of its contract holders in such other state; and when the laws of any other state require such deposit less in amount, such person, association or corporation shall file a certificate from the proper officer in such state with the insurance commissioner of this State showing the amount of the deposit made, and shall deposit with the treasurer of this State an amount which, together with the deposit made in such other state, shall make up the total amount required by this State to be deposited by such person, association or corporation, and such contract holders in such other state shall not be entitled to the benefit of the securities deposited with the treasurer of this State under this article, except so much of such deposit as may be made to complete the total amount required by this article where the law of any other state requires a lesser amount.

33-9-10:

Authority of Insurance Commissioner; Control of Deposit Where License Revoked.—The insurance commissioner shall have the same authority over every person, association, or corporation engaged in selling annuity contracts, certificates, or bonds, as over insurance companies, and if in his opinion the assets are impaired or such person, association or corporation is not complying with the law, said commissioner shall have authority to revoke the license of such person, association, or corporation to do business in this State, and, if such license is so revoked, the deposit or a sufficient amount of same, shall remain under the authority and control of the insurance commissioner until the total liability of all the contracts, certificates or annuity bonds or contracts issued by such person, association or corporation in this State is redeemed or settled.

33-2-45:

Proceedings in Circuit Court of Kanawha County against Insolvent Company.—Whenever any company under the supervision and regulation of the insurance commissioner shall become insolvent or shall be in such financial condition as not to be able to pay its creditors in this State, the commissioner of insurance may file a bill in the circuit court of Kanawha county for the administering of the assets of such company as an insolvent, and for the purpose of taking possession of its property in this State and the distribution of its assets among those entitled thereto according to their respective right.

33-2-12:

Time Licenses Shall Continue in Force.—All licenses, or certificates of authority issued by the insurance commissioner to insurance companies or associations, or agents, solicitors or brokers, shall continue in force until the first day of April next following their issuance unless the same be sooner revoked.

Article VI, Section 35, Constitution of West Virginia:

The State of West Virginia shall never be made defendant in any court of law or equity, except the state of West Virginia, including any subdivision thereof, or any municipality therein, or any officer, agent, or employee thereof, may be made defendant in any garnishment or attachment proceeding, as garnishee or suggestee.

FILE COPY

IN THE

# Supreme Court of the United States

OCTOBER TERM, 1942

No. 319

FIDELITY ASSURANCE ASSOCIATION, a corporation, Debtor, and CENTRAL TRUST COMPANY, Trustee for Fidelity Assurance Association,

Petitioners,

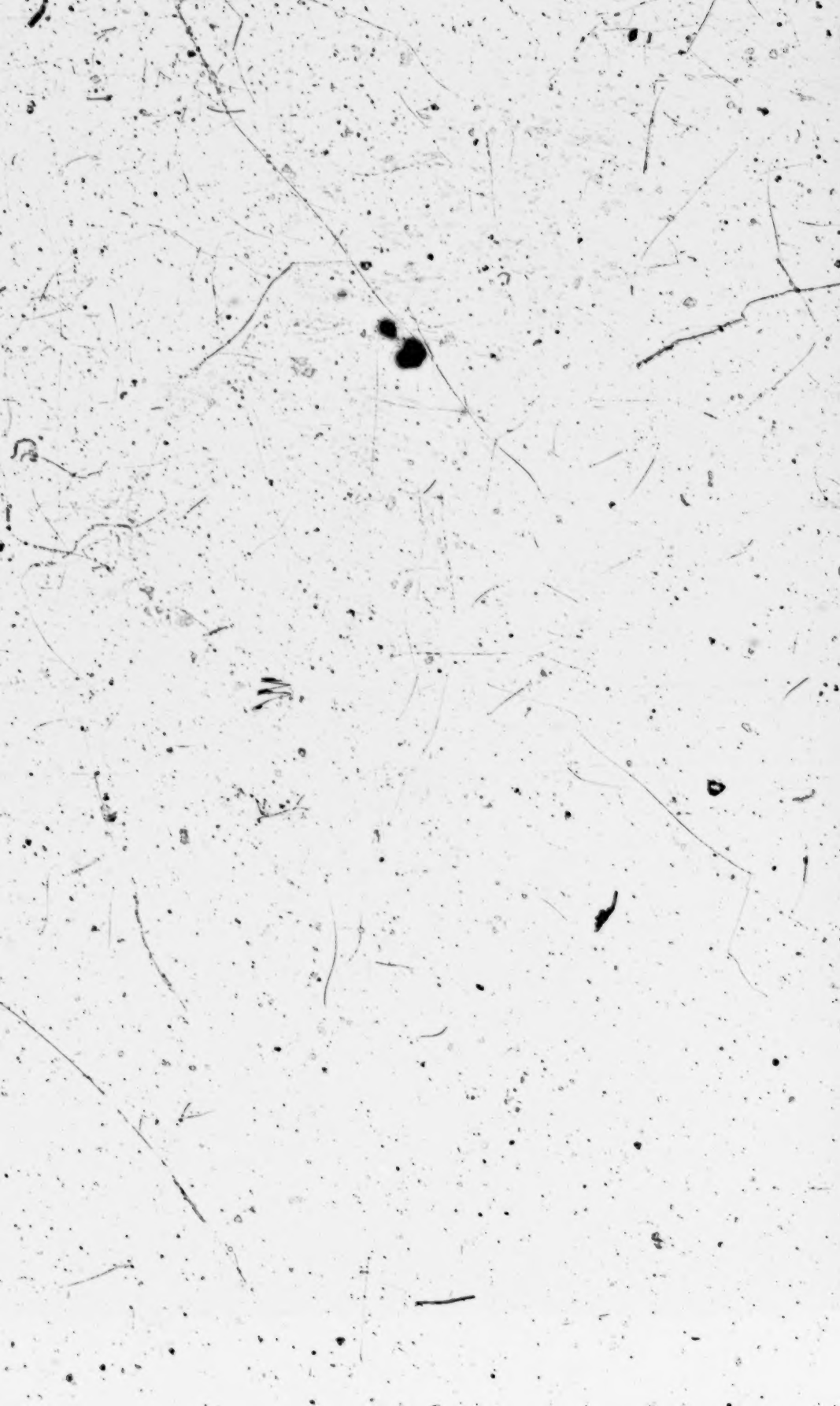
v.

EDGAR B. SIMS, Auditor of the State of West Virginia, and Ex-Officio Insurance Commissioner of the State of West Virginia; ROSS B. THOMAS and H. ISAIAH SMITH, West Virginia State Court Receivers; BANKING COMMISSION OF WISCONSIN; CHAS. R. FISCHER, Commissioner of Insurance and Permanent Receiver for debtor corporation in and for the State of Iowa; JOHN B. GONTRUM, Insurance Commissioner of the State of Maryland; DEWEY S. GODFREY, Missouri State Court Receiver; L. H. BROOKS, Trustee; FREDERIC LEAKE and A. L. GOLDBERG, Jr., Trustee; and SECURITIES AND EXCHANGE COMMISSION,

Respondents.

## Brief of Respondents, Banking Commission of Wisconsin and Chas. R. Fischer, Commissioner of Insurance and Permanent Receiver for the State of Iowa in Opposition to Petition for Writ of Certiorari to the United States Circuit Court of Appeals for the Fourth Circuit

JOHN E. MARTIN,
Attorney General, State of Wisconsin,
JAMES WARD RECTOR,
Deputy Attorney General, State of Wisconsin,
RICKARD H. LAURITZEN,
Assistant Attorney General, State of Wisconsin,
Attorneys for Respondent,
Banking Commission of Wisconsin.
JOHN M. RANKIN,
Attorney General, State of Iowa,
FLOYD PHILBRICK,
First Assistant Attorney General, State of Iowa,
CARL J. STEPHENS,
BEN C. BUCKINGHAM,



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IN THE

# Supreme Court of the United States

OCTORER TERM, 1942

No. 319

FIDELITY ASSURANCE ASSOCIATION, a corporation, Debtor, and CENTRAL TRUST COMPANY, Trustee for Fidelity Assurance Association,

Petitioners,

v.

EDGAR B. SIMS, Auditor of the State of West Virginia, and Ex-Officio Insurance Commissioner of the State of West Virginia; ROSS B. THOMAS and H. ISAIAH SMITH, West Virginia State Court Receivers; BANKING COMMISSION OF WISCONSIN; CHAS. R. FISCHER, Commissioner of Insurance and Permanent Receiver for debtor corporation in and for the State of Iowa; JOHN B. GONTRUM, Insurance Commissioner of the State of Maryland; DEWEY S. GODFREY, Missouri State Court Receiver; L. H. BROOKS, Trustee, FREDERIC LEAKE and A. L. GOLDBERG, Jr., Trustee; and SECURITIES AND EXCHANGE COMMISSION,

Respondents.

**Brief of Respondents, Banking Commission of Wisconsin and Chas. R. Fischer, Commissioner of Insurance and Permanent Receiver for the State of Iowa in Opposition to Petition for Writ of Certiorari to the United States Circuit Court of Appeals for the Fourth Circuit**

## OPINIONS BELOW

The opinion of the District Court (R. 3) is reported in 42 F. Supp. 973. The opinion of the Circuit Court of Appeals (R. 362) is reported in 129 F. (2d) 442.

## STATEMENT OF THE CASE

The statement of the case made by the petitioners in their petition and supporting brief is in many respects complete and accurate. There are certain important omissions, however, to which attention should be invited. To a certain extent this will require repetition of matters stated by petitioners, since it is impossible to supplement their statements in a piecemeal manner and at the same time to give an account of the matter in controversy which is readily understandable.

The supplementary statement which we feel compelled to make is rendered rather difficult by the fragmentary record which has been printed. Some of the material to which we shall refer is not found in the printed record. In cases where such references are made, we refer to statements in the reporter's transcript in the District Court, as, (T. —). Exhibits not found in the printed record are referred to as (Ex. — T. —). Thus, the exhibit and page of the reporter's transcript at which the exhibit was introduced is noted. We recognize that in so identifying matters which are found in the complete unprinted record we are not literally complying with the rules of this Court. On the other hand, we know of no other way in which the matter can be properly presented in view of the petitioners' failure to print a complete record or to arrange for a stipulation covering relevant material.

### A. Statement as to the status of petitioner, Fidelity Assurance Association, as an insurance corporation

As appears from the petitioners' statement and from the opinions in both of the lower courts, Fidelity was originally incorporated on April 11, 1911, and with one charter

change in November, 1912, operated as an annuity company until December 31, 1940. It is also pointed out by petitioners that from November, 1912 until December 31, 1940, Fidelity's activity brought it within the scope of art. 9, entitled "Annuity Contracts" of Ch. 33, entitled "Insurance and Annuity Contracts," of the West Virginia Code, which reads in part:

> "No person, association or corporation shall engage in the business of soliciting or receiving deposits or payments on any annuity contract or certificate or annuity bond in fixed and stipulated installments, within this State, without first having obtained from the insurance commissioner a license to do business in this State: Provided, however, That this article shall not be construed as applying to persons, associations or corporations engaged in selling merchandise in installments, insurance companies, foreign or domestic, duly authorized to do business in this State, building and loan associations, national banks and banking institutions organized and authorized to do business under the laws of this State, fraternal insurance societies, or surety companies doing business under the laws of this State. Such license shall be issued for one year, or the fractional part of a year, and for issuing the same a fee of ten dollars shall be charged; and the provisions of section twelve, article two of this chapter [which provide for expiration April 1 each year] shall apply to such license." (Ch. 33, art. 9, sec. 1, West Virginia Code)

On December 31, 1940 Fidelity's articles were amended changing its name to Fidelity Assurance Association, striking from its articles all of its prior corporate purposes and inserting in lieu thereof the following statement of its sole corporate purpose:

"To issue insurance upon the lives of persons and every insurance appertaining thereto and connected therewith, and to grant, purchase and dispose of annuities." (Ex. 24; T. 497)

At the time of this charter amendment the statutes of West Virginia read in part:

"Life insurance companies chartered by and doing business in this State, and empowered to make contracts contingent upon life, may grant and issue annuities, either in connection with or separate from contracts of insurance based upon life risks, and all such annuities heretofore issued by such companies shall be valid." (Ch. 33, art. 3, sec. 7, West Virginia Code)

On the day of its charter change to an insurance corporation, Fidelity was licensed by the Insurance Commissioner of West Virginia to engage in the life insurance business (Ex. 24; T. 497). Under the provisions of West Virginia law, all licenses issued by the Commissioner of Insurance expire on April 1, Ch. 33, art. 2, sec. 12, West Virginia Code, and consequently the insurance company license expired on April 1, 1941. At that time application was made for a new license which was made out but withheld by the Insurance Commissioner (R. 361), who instituted receivership proceedings a few days later.

The insurance company license was issued under what has been termed a "gentlemen's agreement" between the Commissioner and Fidelity that no insurance policies or annuity contracts would be sold pending specific permission by the Commissioner. The Insurance Commissioner stated that the insurance license was granted in order that Fidelity could continue to receive payments under existing annuity contracts (T. 509)

It is conceded by the petitioners in this Court (Pet. for cert. p. 7), and was conceded in both of the lower courts that Fidelity's object in amending its corporate charter was to escape the regulation imposed by the Investment Company Act of 1940.

As expressed by A. L. King, who had been a director, assistant treasurer, vice-president, comptroller and secretary of Fidelity for many years, "Well, with the amended S. E. C. Statute—whatever you call it—coming into force on January 1st, we knew previous to that time that we could not continue to sell our contracts as Fidelity Assurance—Investment Association after that date. We felt, in view of the fact that we had been selling an insured contract for a period of four or five years which appealed to the public, that we could convert our association into an insurance company and broaden our field of activity to include other types of insurance and make a specialty of the sale of an insured contract that would pass the requirements of the State Insurance Commissioner." (T. 1721-1722).

The Circuit Court of Appeals found that the object of the change to an insurance company was to escape the Investment Company Act of 1940 (R. 379).

On the day that the insurance company license was issued, a meeting of Fidelity's board of directors was held. The minutes of the board for that meeting read in part:

"The directors were informed that the Secretary of State of West Virginia certified the amendment authorizing the corporation to change its name to Fidel-

[1]The change to an insurance company was made December 31, 1940. The regulatory provisions of the Investment Company Act of 1940 which had been enacted on August 22, 1940 were to become effective January 1, 1941 as to transactions in annuities by companies such as Fidelity had theretofore been. 15 U. S. C. A. 80a-52.

ity Assurance Association as of December 31, 1940. The directors were also advised that the Auditor and Insurance Commissioner ex-officio of West Virginia has issued a license to the company as a life insurance company on the same date." (P. 156 of Ex. 100; T. 2863)

The minutes further show at the designated page and exhibit that it was moved and adopted that the company, since it was now a qualified and licensed life insurance company, should thereafter assume the insurance feature of its outstanding Series B contracts carrying that feature. The minutes also show that the president was instructed to immediately send out to contract holders a letter, and a rider to be attached to Series B contracts.

The letter and rider read as follows:

"Organized 1911

FIDELITY ASSURANCE ASSOCIATION
Wheeling, West Virginia
Offices in Principal Cities
December 31, 1940

Dear Contract-owner:

It is with pleasure and confidence that we direct your attention to the change in our name and the widening of the scope of our business to that of issuing insurance on the lives of persons. In the future, the company will be known as Fidelity Assurance Association and will offer a complete line of life insurance policies of all types and classes, including life annuities.

These changes enable us, as a qualified legal reserve life insurance company to assume the risks and obligations provided in Section 6 of your contract. As you know, this Section makes available to you insurance covering all

monthly payments not yet made in event of your death. Such insurance protection has, in the past, been procured from a legal reserve life insurance company, but was subject to cancellation, upon due notice, at any time. With the making of your regular monthly payments and the Association assuming the insurance, this condition has been eliminated.

By resolution of the Board of Directors and by the rider enclosed in duplicate, the Association assumes and itself agrees to fulfill and pay the risk and obligations of the insurance policy and of the insurance company mentioned in Section 6 of your contract. The original of the rider is to be signed and attached to your Income Reserve Contract, Series B and the other (the blue one) signed and returned to the Association in the enclosed envelope.

Cordially yours,

F. S. Risley

FsR:GA

F. S. RISLEY, President

N. B. The number of the contract to which the rider is to be attached and be a part is found at the bottom of the rider."

* * * *

"FIDELITY ASSURANCE ASSOCIATION ASSUMPTION OF RISK AND RIDER ATTACHED TO AND A PART OF INCOME RESERVE CONTRACT SERIES "B" NUMBER

The Association, having so amended its charter as to authorize it to issue insurance upon the lives of persons and every insurance appertaining thereto and to grant and dispose of annuities, and to change its name to Fidelity Assurance Association, in consideration of the monthly payments, provided for in the above numbered contract hereby assumes and does itself hereby agree to fulfill and pay all

the risks and obligations of the insurance policy and the insurance company mentioned in Section 6 of said contract.

It is hereby agreed between the Association and the contract holder that this insurance agreement shall become and be a part of said contract and the original shall be attached thereto.

Executed in duplicate at Wheeling, West Virginia this 31st day of December, 1940.

FIDELITY ASSURANCE ASSOCIATION

F. S. Risley
President

Contract Owner."

At the hearing in the District Court Fidelity's officials testified that no insurance contracts had been written by the company. The fact that such contracts had been written was not then known by those opposing the petition. Pending the hearing in the Circuit Court of Appeals, it was discovered that insurance contracts composed of executed riders had been entered into. The matter was brought to the attention of the Circuit Court of Appeals by motion to remand the case, and in connection with the consideration of the motion and the case, counsel for Fidelity, by written stipulation in open court, conceded that 9,802 contracts of insurance had been entered into after December 31, 1940 by reason of execution and return of the riders to which attention has been called (R. 361).

Petitioners now assert at p. 10 of their petition that Fidelity did not assume these insurance obligations because it was never authorized to engage in the insurance business

in West Virginia and the insurance obligations continued to be carried by the Lincoln National Life Insurance Company as they were before. They refer to the "record" at p. 356 in support of these statements.

At the argument in the Circuit Court of Appeals the matter of Fidelity's life insurance license was a subject of considerable controversy. When confronted with a certified copy of the license which had been issued (see Ex. 24, T. 497) and by the direct testimony of the Commissioner of Insurance that it had been issued (T. 500), with no evidence to the contrary, petitioners abandoned all claim that no such license was issued, and the Court found that the license was issued.

So far as appears, Fidelity continued to keep in force in Lincoln National Life Insurance Company the group insurance policy which covered its Series B contracts and for which it exacted payment from the contract holders, and the Court so found.

Aside from the assumption of liability on the 9,802 insurance contracts, Fidelity transacted no new business after it was chartered and licensed as a life insurance company. It issued no further annuity contracts and confined its annuity business to accepting payments on existing contracts, paying out on matured contracts and making contract loans (Op. D. C., R. 11-12).

During this period Fidelity filed proposed forms of new annuity and life insurance policies with the Insurance Commissioner of West Virginia pursuant to the provisions of the law as a condition precedent to the sale of such policies (Op. C. C. A., R. 367), and on January 24, 1941 again amended its charter to reduce its authorized capital stock to $1,000,000 shares of common stock, of a par value of

$8.00 per share. The resolution authorizing the change stated that it was in pursuance of a plan to transact life insurance business outside the State of West Virginia (Op. C. C. A., R. 367).

Of further significance is the fact that Fidelity by letter withdrew its registration with the Wisconsin Banking Commission as an investment company, effective December 31, 1940. It advised the Commission in connection with this withdrawal that it was entering the field of life insurance (Ex. 93, T. 2444).

**B. Statement as to Fidelity's good faith in filing the petition for reorganization.**

The Circuit Court of Appeals decided that the prior proceedings pending in the state courts would best subserve the interests of Fidelity's creditors. Petitioners seek to have this determination reviewed, but few facts are set forth in the petition as to the nature of the proceedings in the various state courts (such facts were fully developed on the record), and, therefore, in order that the interest and position of these respondents may be made clear, we deem it desirable to point out certain facts as to the nature and history of Fidelity's operations in Wisconsin and Iowa and the nature and history of the proceedings instituted in Wisconsin and Iowa and in other states prior to the filing of debtor's petition for reorganization.

**1. The operations and proceedings in Wisconsin**

In Wisconsin, Fidelity was licensed to sell its contracts from June 26, 1930 to the close of 1940. It was licensed annually under Chapter 216 of the Wisconsin Statutes (R. 40-41) pertaining to "investment associations." Under this chapter it was subject in Wisconsin to all of the laws of Wisconsin pertaining to foreign building and loan associa-

tions. Sec. 215.38, Wis. Stats. (R. 42), which was applicable to Fidelity, provided that it could not transact business in Wisconsin unless it should

> "* * * have and keep on deposit with the state treasurer, in trust for the benefit and security of all its members in this state, five hundred thousand dollars to be held in trust as aforesaid until all shares of such association held by residents of this state shall be fully redeemed and paid off and until its contracts and obligations to persons and members residing in this state shall have been fully performed and discharged. * * *"

It was also provided that the securities comprising the deposit should be approved by the Banking Commission of Wisconsin, and, further, that whenever the Banking Commission should find that the liability on contracts held by persons residing in Wisconsin exceeded ninety per cent of the deposit, the Commission would require the deposit of additional securities (sec. 215.395, Wis. Stats., R. 43). Its contracts were also subject to the securities law of Wisconsin, Chapter 189, Wis. Stats. The laws of Wisconsin, insofar as pertinent here, under which Fidelity operated and was subject, are shown at R. 40 to 59.

As of April 10, 1941 Fidelity's "net cash liability" on contracts held by Wisconsin residents was $2,342,978.73, while the market value of the securities were, according to Fidelity's figures as of June 6, 1941, $2,619,399.07. A sales value of over $1,000,000 in face amount of contracts per month was reached in Wisconsin, which was one of the five states in which the company had its largest volume of sales (Ex. 48, T. 1116). Approximately six thousand contracts are presently outstanding in Wisconsin (Ex. 34, T.

757) out of the approximately 22,000 to 25,000 "active" contracts outstanding in total (R. 211). In the sale of the contracts in Wisconsin, the Wisconsin deposit law was emphasized (T. 3172), and the greatest stress was laid upon the fact that the company was supervised by the Banking Commission of Wisconsin and had securities on deposit with the State Treasurer there. A large number of the Wisconsin contract holders purchased their contracts upon the representations made to them as to the protection afforded by the Wisconsin law (Ex. 114, T. 3546, R. 65-74).

After advising the Banking Commission of Wisconsin under date of December 31, 1940 that it had become an insurance company and would no longer sell its contracts in Wisconsin, as has heretofore been pointed out, no further contracts were sold there. In fact, the sale of contracts had ceased in Wisconsin and elsewhere some time before this, Fidelity's license having been suspended in most states in 1938 or 1939 (T. 368). Upon the company's ceasing payment of its obligations to contract holders, and on April 14, 1941, three days after the institution of the West Virginia state court proceedings by the Insurance Commissioner of West Virginia, the Banking Commission of Wisconsin took possession of the Wisconsin business and assets of Fidelity under appropriate statutory proceedings, particularly sec. 215.33, Wis. Stats. (R. 60-63) in the Circuit Court for Dane County, Wisconsin. Due notice to Fidelity and its officers was given, as provided by statute. Fidelity entered its appearance therein by counsel, interposed no objection thereto and took no appeal from the action of the Banking Commission of Wisconsin. A certified copy of the Wisconsin proceedings comprises Exhibit 120 of the original record herein. The Banking Commission was and is represented

in the Wisconsin proceedings by the attorney general under provisions of Wisconsin law providing therefor. No fees either for counsel or receivers are being exacted in the Wisconsin proceedings. By operation of law (sec. 215.33 (8), Wis. Stats.) and as provided by the order of April 14, 1941 of the Circuit Court for Dane County (R. 60), title to and possession of all of Fidelity's assets located in Wisconsin were vested in the Banking Commission of Wisconsin "to be administered by the Banking Commission of Wisconsin under the supervision and control of the Circuit Court for Dane County, Wisconsin for the benefit and security of contract, bond or certificate holders, residents of this state * * *". (R. 61). The filing of the notice of taking possession operated, under sec. 215.33 (8), Wis. Stats., as a bar to any other action against Fidelity or its assets in Wisconsin.

Pursuant to court order dated May 16, 1941 substantially all of the Wisconsin contract holders duly filed their claims with the Banking Commission of Wisconsin (Ex. 114, T. 3546, R. 65-74) along with their actual Fidelity contracts (T. 1057).

On May 27, 1941, pursuant to order of the court and with the express consent of counsel for Fidelity, the Banking Commission of Wisconsin liquidated and sold certain of the deposited securities realizing the sum of $1,259,244.04, and these funds are still held by the Banking Commission of Wisconsin (Ex. 120, T. 3803). Of the Wisconsin deposit there remain certain securities which we consider to be the equivalent of cash and which may be readily sold without expense or difficulty, these securities being as follows:

| | *Par Value* |
|---|---|
| City of Milwaukee—<br>Park 5% 1949 | $ 50,000.00 |
| City of Milwaukee—<br>Sewer 5% 1947 | 30,000.00 |
| City of Milwaukee—<br>Sewer 5% 1948 | 50,000.00 |
| City of Milwaukee—<br>Sewer 5% 1949 | 50,000.00 |
| City of Milwaukee—<br>Sewer 5% 1950 | 25,000.00 |
| United States Treasury—<br>2⅞—1960-55 | 160,000.00 |
| United States Treasury—<br>3¼—1946-44 | 34,000.00 |
| United States Treasury—<br>¾ Sept. 1944 | 800,000.00 |
| | $1,199,000.00 |

After the Wisconsin proceedings had been commenced and carried forward as above outlined, the Banking Commission was notified on June 9, 1941 by telegram signed by the Central Trust Company of Charleston, West Virginia, that the District Court for the Southern District of West Virginia had on June 6 approved the filing of a petition for reorganization of Fidelity. Subsequently copies of ex parte orders of the District Court dated June 6 and June 10 ordering the Banking Commission of Wisconsin to turn over assets in its possession to the Central Trust Company, were received by the Banking Commission. The Banking Commission did not comply with these purported or-

ders, but voluntarily held the Wisconsin proceedings in abeyance pending the determination of the jurisdiction of the federal court upon the proceedings had on its controversial answer and the answers of the other respondents herein to debtor's petition for reorganization. The Banking Commission has, however, maintained close contact with Fidelity's Wisconsin contract holders and has participated in discussions with other state authorities looking to the facilitation of the administration and distribution of Fidelity's assets in the Wisconsin proceedings as well as in the other state proceedings.

A large number of the Wisconsin contract holders have expressed themselves unequivocally that they are in no way interested in any proposed reorganization proceedings in West Virginia or elsewhere and are desirous of having the Wisconsin proceedings go speedily forward to the end that they may receive their proper share of the funds to be distributed there (Ex. 114, T. 3546, R. 65-74).

**2. The operations and proceedings in Iowa**

In Iowa Fidelity was granted a certificate of authority by the Auditor of State on or about January 7, 1927 pursuant to Chapter 392, 1927 Code of Iowa (R. 75-78). An initial deposit of $25,000 was made under the pertinent statutes, "guaranteeing the faithful performance of all contracts entered into," and thereafter additional securities were deposited in an amount at all times equal to its liabilities in Iowa. In 1930 Fidelity registered its investment contracts in Iowa under the provisions of Chapter 393.1, Iowa Code, as an issuer-dealer, but failed to secure the renewal of this license in 1936, after which time it was not permitted to sell new contracts in Iowa. In order that

Fidelity might continue to collect and disburse on its outstanding contracts, it filed application in December, 1927 for a permit to do business as a foreign corporation under Chapter 386, 1935 Code of Iowa. The laws of Iowa, insofar as pertinent here, to which Fidelity was subject, are shown at R. 75 to 89.

Fidelity's "net cash liability" to Iowa contract holders was approximately $35,000 and securities were deposited in Iowa of the approximate par value of $42,000. This deposit was made in trust for the purpose of guaranteeing faithful performance of Fidelity's contracts and title to the trust deposit was vested in the Auditor of State and, under the present law, in his successor, the Commissioner of Insurance.

After the commencement of the state court proceedings in West Virginia and on April 16, 1941, the Attorney General of Iowa, on behalf of Charles R. Fischer, Commissioner of Insurance, commenced an action in the District Court for Polk County, Iowa for administration of the Iowa assets in accordance with the provisions of Chapters 392 and 393.1, Code of Iowa 1939, and on May 19, 1941 was appointed permanent receiver in Iowa. The Iowa assets were administered by the Iowa Commissioner of Insurance up to the time Fidelity filed its petition for reorganization, and the Iowa proceedings have been voluntarily held in abeyance since that time. The securities comprising the Iowa deposit are still held by the Commissioner of Insurance there.

**3. The proceedings in other states**

In a number of other states the state authorities had also commenced appropriate proceedings prior to the filing of the petition for reorganization.

On April 4, 1941 the Auditor and Ex-Officio Insurance Commissioner of West Virginia ordered Fidelity to cease payment on its contracts by reason of the fact that it appeared it could no longer meet its obligations, and on April 11, 1941 the Attorney General of West Virginia, at the instance of the Auditor and Ex-Officio Commissioner of Insurance, instituted insolvency proceedings against Fidelity in the Circuit Court for Kanawha County, West Virginia. Fidelity appeared in this suit, interposed no objection thereto, and receivers of the company's "free" assets were appointed. One of these receivers was later employed by the Central Trust Company to manage Fidelity's affairs in the federal proceedings. The Insurance Commissioner of West Virginia notified the various other state authorities of his action and asked that they institute proceedings with respect to the assets in their respective states (T. 730). The securities deposited in West Virginia are still held by the State Treasurer there, and the Auditor and Ex-Officio Insurance Commissioner of West Virginia is one of the respondents here.

The Attorney General of Ohio, at the instance of the Superintendent of Insurance of Ohio, instituted appropriate proceedings in the Common Pleas Court of Franklin County, Ohio, and filed an answer controverting the allegations of Fidelity's petition for reorganization. Ohio's answer was later withdrawn upon the entry of an order by the District Court herein on October 29, 1941 consenting that the securities on deposit in Ohio should remain there

until such time as a plan of reorganization might be adopted in the federal proceedings but without prejudice to Ohio's status as an intervenor.

The Secretary of State of Illinois, with whom the deposit was made there, commenced appropriate proceedings in the Circuit Court of Sangamon County of Illinois, and the Atttorney General of Illinois filed an answer controverting the debtor's petition for reorganization. This answer was withdrawn upon the entry of an order by the District Court on October 4, 1941 providing that the securities on deposit in Illinois should remain there pending the federal proceedings.

In Tennessee certain contract holders filed a bill in the Chancery Court for Davidson County, Tennessee, to enforce their lien upon the securities deposited with the State Treasurer of Tennessee. These Tennessee contract holders intervened and filed an answer controverting debtor's petition in the federal proceedings and are respondents herein. The deposited securities are still held by the State Treasurer of Tennessee.

In Missouri a receiver was appointed at the request of the Commissioner of Securities there and the Missouri receiver filed an answer controverting Fidelity's petition for reorganization, and is one of the respondents herein. The deposited securities are still held by the Commissioner of Securities of Missouri.

The Insurance Commissioner of Maryland instituted appropriate proceedings there and is one of the respondents herein. The deposited securities are still held by him.

The Securities Commissioner of the State of Kansas entered his appearance in the federal proceedings through counsel. The deposited securities are still held in Kansas.

In all of the states having deposits and where proceedings were not instituted prior to the filing of the petition for reorganization, the appropriate authorities have conferred with the authorities of the other states and are ready to carry on such proceedings as soon as the order of the Circuit Court of Appeals becomes final.

## QUESTIONS DECIDED BY THE CIRCUIT COURT OF APPEALS

The Circuit Court of Appeals decided two propositions of law in determining the case:

1. That Fidelity was an "insurance corporation" within the meaning of Section 4 of the Bankruptcy Act as amended by the Act of June 25, 1910, 36 Stat. 839, 11 U. S. C. A. sec. 22,[1] and therefore excepted from those corporations which are subject to bankruptcy;[2]

2. That at the time Fidelity's petition was filed, prior proceedings were pending which it appeared would best serve the interest of creditors and stockholders and that the petition was subject to dismissal under sections 144 and 146 (4) of Chapter 10 of the Bankruptcy Act; 11 U. S. C. A. 544, 546 (4).[3]

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[1]Appendix 64.
[2]In Chapter 11b proceedings such corporations are excluded. 11 U. S. C. A. 506 (3), App. p. 66.
[3]Appendix 67.

## ARGUMENT

### I. THE PETITION FOR CERTIORARI AND SUPPORTING BRIEF DISCLOSE NO GROUNDS FOR THE ISSUANCE OF THE WRIT TO REVIEW THE FINDING THAT FIDELITY WAS AN INSURANCE CORPORATION

#### A. Fidelity was chartered, licensed and did business as a life insurance corporation under the laws of West Virginia

As we pointed out in our statement of the case, Fidelity amended its articles on December 31, 1940, changing its name to Fidelity Assurance Association and changing the statement of its corporate purposes so that thereafter its sole purpose was to issue life insurance and to grant, purchase and dispose of annuities (Ex. 24; T. 497).

We have also pointed out that under the law of West Virginia life insurance companies, in addition to issuing life insurance, are empowered to grant and issue annuities. Ch. 33, art. 3, sec. 7, West Virginia Code.

Fidelity was granted a license to engage in business as a life insurance corporation (Ex. 24; T. 497). Under this license it issued 9,802 life insurance contracts and continued to receive payments on existing annuity contracts, made loans on such contracts, and paid out matured contracts.[1]

There is not one slight doubt but that Fidelity was chartered, licensed and did business in the State of West Virginia as a life insurance company under the insurance

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[1]Insurance corporations licensed to do business in West Virginia are excluded from licensing provisions relating to annuity companies. (See Ch. 33, art. 9, sec. 1, West Virginia Code, set out on p. 3). Fidelity having become a duly licensed insurance company and under such license authorized to deal in annuities, was not thereafter included within the licensing provisions relating to annuity companies. This was recognized by the Commissioner of Insurance when he testified that he licensed the company as a life insurance company in order to permit it to continue such activities with respect to existing annuity contracts (T. 500).

laws of that State after December 31, 1940 and prior to April 1, 1941. Nor, in view of the communication sent out to the Banking Commission of Wisconsin, the minutes of Fidelity's board of directors, and the communications sent out to contract holders, all of which are referred to in our statement of the case, is there the slightest doubt but that Fidelity planned to become a life insurance corporation, and that it thought that it had become such a corporation.

As pointed out in our statement of the case, the petitioners state that Fidelity did not assume any insurance obligations because, as they say, it was not authorized to do so and continued to keep its group policy in force with Lincoln National Life Insurance Company. These arguments and the document upon which they are in part based (Affidavit of F. J. McNulty, R. 356), were considered by the Circuit Court of Appeals and it found that Fidelity was authorized to and did in fact issue insurance contracts.

**B. Fidelity's charter purposes were such after the amendment on December 31, 1940 as to constitute it a life insurance corporation according to the generally recognized classification of such corporations by the States of the United States**

In the appendix to our brief in the Circuit Court of Appeals we referred to the statutes of many of the states providing for the incorporation of life insurance companies. These statutes are set out at pp. 100-113 of the record and are referred to in the opinion of the Circuit Court of Appeals in a footnote (R. 380).

A study of these statutes discloses that thirty-five states today classify life insurance corporations upon the

basis of a charter power to issue life insurance and to grant, purchase and dispose of annuities.

At the time that life insurance corporations were excluded from the Bankruptcy Act (Act June 25, 1910, Ch. 412, sections 3 and 4, 36 Stat. 839) twenty-eight states so defined their charter purposes.

Of the states which did not in 1910 and do not now so define life insurance corporations, few have a statutory definition of any character.

### C. Fidelity's activities after its charter amendment were those of an insurance corporation

After it was chartered and licensed as a life insurance corporation, Fidelity issued contracts of life insurance and continued to deal in annuities to the extent that it received payments, made loans and paid out on existing contracts. The petitioners apparently concede that the issuance of life insurance contracts constitutes a proper activity of a life insurance corporation, but they contended below and apparently contend here that Fidelity's annuity transactions constituted the principal part of its business after its charter change and that this activity transformed it into something other than a life insurance corporation.

Their argument comes down to this: A corporation may, under the laws of West Virginia and of the states of the United States generally, be classified as a life insurance corporation upon the basis of a charter power to deal in life insurance and annuity contracts. On the other hand, if it deals in annuity contracts to a greater extent than it deals in life insurance policies, it is not an "insurance cor-

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[1] In some cases such corporations are also authorized to issue health and accident insurance.

poration" within the meaning of Section 4 of the Bankruptcy Act, even though it deals in annuities pursuant to its charter powers and license as such.

Two observations can be made with respect to this phase of petitioners' argument.

First. All new business transacted by Fidelity as a life insurance corporation was purely a life insurance business in any sense of the word, namely, the issuance of life insurance contracts.

Second. Commercial life insurance corporations have not, in the past history of the United States, and do not now exist except as they have been and are created by the statutes of the several states. There is no common law definition of a life insurance corporation and such corporations do not exist by virtue of any rule of common law.

It would seem, therefore, that where the words "insurance corporation" are used, as in the Bankruptcy Act, with no definition of those words, they must of necessity refer to the only insurance corporations that now or have ever existed, namely, those created by state statute. In order to determine the characteristics of such a corporation, therefore, it becomes necessary to refer to the statutes of the several states by virtue of which they exist.

We have shown that under the law of West Virginia, and under the law of the states generally, life insurance corporations have certain well-defined and understood characteristics. They are corporations authorized to issue life insurance, to grant, purchase and dispose of annuity contracts, and in some cases to issue health and accident insurance. The government of the United States has recognized this classification of life insurance companies in its statutes taxing life insurance companies, 26 U. S. C. A. sec.

201 (a),[1] and in its statutes providing for R. F. C. loans to insurance corporations, 15 U. S. C. A. sec. 605i.[2]

Under their charter powers to deal in annuities, life insurance corporations may issue such annuities for life, upon the basis of mortality tables, or for a certain period, as in the case of Fidelity's annuities.

*Carroll v. Equitable Life Assur. Soc. of United States*, 9 F. Supp. 223 (D. C., Mo., 1934).

But even where such contracts are based upon mortality tables, they are not, properly speaking, insurance contracts.[3]

It is, nevertheless, recognized that the acivities of life insurance corporations (with charter powers such as those of Fidelity) in dealing in annuities are properly the activities of such companies.

As stated by the Supreme Court of Massachusetts:

> "And the conclusion is irresistible that if the petitioner had issued only contracts for the payment of annuities, it must be deemed to be a life insurance company. If so it would be accurately described as in 'the business of life insurance.' It is none the less so engaged because it also issues policies of life insurance * * *."

*Mut. Ben. Life Ins. Co. v. Commonwealth*, 227 Mass. 63, 116 N. E. 469, 470 (1917).

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[1] Appendix 68
[2] Appendix 28
[3] Old Colony Trust Co. v. Commissioner of Internal Rev., 102 F. (2d) 380 (C. C. A. 1st, 1939); Rishel v. Pacific Mut. Life Ins. Co. of California, 78 F. (2d) 881 (C. C. A. 10th, 1935); In re Walsh, 19 F. Supp. 567 (D. C. Minn., 1937); Commonwealth v. Metropolitan Life Ins. Co., 254 Penn. 510, 98 Atl. 1072 (1916); State v. Lucas, (Mo.) 153 S. W. (2d) 10 (1941); Curtis v. New York Life Ins. Co., 217 Mass. 47, 104 N. E. 553 (1914); People v. Knapp, 193 App. Div. 413, 184 N. Y. S. 345 (1920), affirmed 231 N. Y. 630, 132 N. E. 916 (1924); Daniel v. Life Ins. Co. of Virginia, (Tex. Civ. App.) 102 S. W. (2d) 256 (1937); State v. Equitable Life Assur. Soc., 68 N. D. 641, 282 N. W. 411 (1938); Northwestern Mut. Life Ins. Co. v. Murphy, 223 Ia. 333, 271 N. W. 899 (1937); State v. Ham, 54 Wyo. 148, 88 P. (2d) 484 (1939).

See also:

*Northwestern Mut. Life Ins. Co. v. Murphy*, 223 Ia. 333, 271 N. W. 899, 902 (1937);

*State v. Lucas*, 348 Mo. 286, 153 S. W. (2d) 10 (1941).

Annuities are not insurance but life insurance corporations which are classified as such by virtue of charter power to issue life insurance and to deal in annuities necessarily engage in the activities of life insurance corporations when, pursuant to those charter powers and a license to conduct a life insurance business, they deal in annuities.

**D. Petitioners' arguments considered**

On page 17 of the brief in support of their petition the petitioners summarize five separate arguments directed to the proposition that the Court should issue a writ of certiorari to the Circuit Court of Appeals by reason of its disposition of the insurance company question. These arguments are elaborated in later portions of their brief. Each of these points will be discussed, but for purposes of clarity we prefer to treat them out of the order in which they are stated by the petitioners.

**1. The point (petitioners' point No. 4) that Fidelity was not classified as an insurance corporation under the law of West Virginia**

We dispose of this point in our argument beginning at p. 20, *supra*. We shall add nothing here except to point out that the petitioners' claim that Fidelity was not an insurance company under West Virginia law is directed entirely to the status of the corporation prior to the charter amendment on December 31, 1940. We have made no claim

and make none here that Fidelity was an insurance company prior to December 31, 1940.

**2. The point (petitioners' point No. 3) that the decision of the Circuit Court of Appeals is probably in conflict with applicable decisions of this Court**

Petitioners' argument on this point is based upon the cases of *Bowers v. Lawyers Mortgage Company*, 285 U. S. 182, 52 S. Ct. 350, 76 L. ed. 690 (1932) and *United States v. Home Title Insurance Co.*, 285 U. S. 191, 52 S. Ct. 319, 76 L. ed. 695 (1932).

In those cases corporations were organized under the insurance laws of New York for the purpose of guaranteeing real estate mortgage obligations and engaging in a general real estate mortgage broker's business. The question at issue was whether the corporations were insurance corporations for tax purposes. It was held that one corporation was an insurance corporation and that the other was not. These decisions were rested upon the ground that for purposes of the tax law there under consideration the character of a corporation was to be determined by its activities; that the activities of guaranteeing real estate mortgage obligations were insurance activities and that such activities were predominate in the case of the one corporation but were subsidiary in the case of the other.

A similar real estate mortgage guarantee corporation filed a petition for reorganization under Section 77B of the Bankruptcy Law following the decision in the *Bowers* and *Home Title Insurance Co. cases*. Upon the authority of those cases it was argued that the principal activities of the company were not those of guaranteeing mortgages and that consequently it was not an insurance corporation within the meaning of the Bankruptcy Act. The Second

Circuit Court of Appeals held that the *Bowers* and *Home Title Insurance Co* cases were inapplicable and that considerations which obtained for purposes of administering the taxation laws involved in those cases were not apposite in determining the character of a corporation for the purposes of the Bankruptcy Law.

*In re Union Guarantee & Mortgage Co.*, 75 F. (2d) 984 (C.C.A. 2d, 1935).

Certiorari was denied by this court, *Union Mortgage & Guarantee Company v. Van Schaick, etc.*, 296 U. S. 594, 56 S. Ct. 142, 80 L. ed. 421 (1935). If it did not consider that a writ of certiorari was necessary to resolve any supposed conflict with the *Bowers* and *Home Title Insurance Co.* cases raised by *In re Union Guarantee & Mortgage Co.*, 75 F. (2d) 984 (C. C. A. 2d, 1935), it becomes difficult to determine just how any such supposed conflict can be asserted as the basis for the issuance of a writ in this case. But whatever may have been the situation with respect to any conflict raised with the *Bowers* and *Home Title Insurance Co.* cases by the *Union Guarantee & Mortgage Co.* case, there is no such conflict in the present case.

Those cases dealt with insurance corporations of an entirely different character than that of a life insurance corporation. So far as life insurance corporations are concerned, they are defined for purposes of federal taxation as an "insurance company engaged in the business of issuing life insurance and annuity contracts (including contracts of combined life, health, and accident insurance), the reserve funds of which held for the fulfillment of such contracts comprise more than 50 per centum of its total reserve funds." 26 U. S. C. A. sec. 201 (a). True enough,

a principal activities test is applicable in the taxation of life insurance companies, but we may note parenthetically that annuities and life insurance are recognized as life insurance activities for purposes of taxation. Consequently, there is no room for a contention that the activity of dealing in annuities, even if it constituted the principal portion of a life insurance company's business, would exclude it from the life insurance classification.

**3. The point (petitioners' point No. 5) that there is a conflict with decisions of other circuit courts of appeal**

It is a fair criticism of petitioners' argument on this point that they ignore the facts and the decision involved in the present case and for the most part confine themselves to an attempted showing that conflicts exist in other cases to which they refer. Assuming that there may be conflicts in some of the decisions with respect to the rationale employed in determining whether a corporation is to be excluded from bankruptcy under Section 4, it would nevertheless appear that some showing should be required that a decision by this court in the case at bar would resolve any such conflicts as might exist. If there is no such conflict applicable to the facts involved in the case at bar, then obviously the court could hardly determine it.

No circuit court of appeals decision laying down principles applicable in determining whether a corporation is a "municipal, railroad, insurance or banking corporation" or "a building and loan association," within the meaning of Section 4 of the Bankruptcy Act, 11 U. S. C. A. 22, has determined a case in conflict with the determination reached by the court below.

The decision of the court below is in accord with cases such as *In re Union Guarantee & Mortgage Co.*, 75

F. (2d) 984 (C. C. A. 2d, 1935). The decisions of other Circuit Courts of Appeal employing the rationale of that case are set out in the opinion of the circuit court of appeals and they, likewise, are consistent with its finding. In fact, they would be inconsistent with any other finding. The rationale of the *Union Guarantee & Mortgage Co.* case is that the status of a corporation as an insurance or banking corporation is to be determined according to the classification of the corporation under the law of the state of its incorporation.

The decision in *Gamble v. Daniel*, 39 F. (2d) 447 (C. C. A. 8th, 1930) contains reasoning which, to some extent, is inconsistent with the reasoning in *In re Union Guarantee & Mortgage Co.*, 75 F. (2d) 984 (C. C. A. 2nd, 1935), and it is conceivable that a case might arise where the result would vary, depending upon whether the reasoning of the one case or the other were to be applied. In the *Gamble* case the question at issue was whether a corporation was a "banking corporation" and as such excepted from Section 4 of the Bankruptcy Act, 11 U. S. C. A. 22. The court held that "banking corporations" meant corporations which were authorized by the laws of their creation to do a banking business and that a banking business consisted of the doing of those things which, in the ordinary conception, were done by banks at the time banking corporations were excluded from bankruptcy (1910). The court held that the corporation involved in the case was not a banking corporation, since it had no power to receive deposits and since such power was in common understanding an essential attribute of the banking business.

The court also held that the corporation was not a banking corporation within the meaning of the state statutes pursuant to which it was created and existed.

It may be noted that the only instance in which a conflict could arise between the *Union Guarantee & Mortgage Co.* case and the *Gamble* case would be where a state were to classify a corporation upon the basis of charter purposes substantially differing from those which were commonly accepted as identifiable with such corporations in 1910. No such case is presented here nor do we know of a case where the question has been presented. It was specifically held by the Circuit Court of Appeals in the present case that Fidelity was an insurance corporation both upon the basis of its classification by West Virginia and by its classification by the laws of the states of the United States generally in 1910.

As we have pointed out in a preceding portion of our argument, commercial insurance corporations did not exist in 1910 and do not exist now except as they are created and their purposes defined by state statutes. Consequently, when in 1910 the laws of the states generally identified life insurance corporations as those corporations authorized to transact business in life insurance and annuities, they necessarily impressed upon the words "life insurance corporation" a commonly accepted meaning.

We are wholly unable to recognize any conflict between the present case and *In re Prudence Co.*, 79 F. (2d) 77 (C. C. A. 2nd, 1935). In that case the question at issue was whether a corporation formed under the New York banking law was a banking corporation within the meaning of Section 4. The New York law was entitled "An act in relation to banking corporations * * * and corporations under the supervision of the banking department." The court held that corporations other than banking corporations could be formed under the New York banking

law,—that Prudence Co. had not acquired the powers of a banking corporation as those corporations existed under New York law and generally, and that consequently it was not a banking corporation excluded from the Bankruptcy Act. Against the claim that the Prudence Company was an insurance corporation, if it was not a banking corporation, the court held that notwithstanding the nature of its business was the same as that done by *Union Guarantee & Mortgage Co.* (75 F. (2d) 984 (C. C. A. 2nd, 1935)) it was not an insurance corporation since it was not organized under the insurance law and was not such in common parlance.

Isolated portions of the opinions in the *Union Guarantee & Mortgage Co.* case and the *Prudence Co.* case, may be shown to be inconsistent with each other upon careful examination. So far as the actual holding of the cases go, there is no inconsistency. Further than that, there is no inconsistency between the holdings of either of the cases or anything that is said in them, and the holding of the Court in the present case.

We have already analyzed the *Union Guarantee & Mortgage Co.* case in its relation to the present one. The consistency of the *Prudence Co.* case is clear. Here the corporation was regarded as an insurance company because it was classified as such by West Virginia and possessed and exercised the powers customarily identifiable with life insurance corporations. There is not one sentence in the *Prudence* case inconsistent with such a holding.

Petitioners seem to imply that the Circuit Court of Appeals held Fidelity to be an insurance corporation by reason of the fact that it was supervised by the Commissioner of Insurance. Thus, they say it is contrary to the

*Prudence* case and to *Capital Endowment Co. v. Kroeger*, 86 F. (2d) 976 (C. C. A. 6th, 1936). This claim is without foundation. There is not the slightest suggestion in the Court's opinion that Fidelity was classified as an insurance corporation upon any such basis. It may be significant that petitioners point to no language to that effect in the opinion.

The petitioners suggest that the holding below conflicts with *Clemons v. Liberty Savings & Real Estate Corporation*, 61 F. (2d) 448 (C. C. A. 5th, 1932). In that case the claim was made that a corporation seeking an adjudication through bankruptcy was either a banking corporation or a building and loan association and, therefore, excluded from bankruptcy under Section 4, 11 U. S. C. A. 22. The Court held that the corporation was not organized as a banking corporation under the state law and that if it occasionally did a banking business, its acts were *ultra vires* and could not operate to make it a bank within the meaning of the Bankruptcy Law. It further held that the corporation was neither organized to do a general savings and loan business nor did such a business as is usually conducted by building and loan associations. As stated by the court (p. 450):

> "It is evident that appellee was organized to do a general savings and loan business, something less than either a bank or a building and loan association. * * *"

There is nothing in the case which is at variance in the slightest degree with the holding of the Court in the present case.

Petitioners' principal effort in endeavoring to spell out a conflict between the case now before the Court and other

decisions is directed toward a claim that some of the other decisions establish an "activities doctrine" to which the present decision does not conform. Their conception of such a doctrine is that the status of a corporation as a bank or insurance corporation is to be determined both by reference to its charter powers and its activities under such powers. Thus, they argued in the Court below that if the charter powers of a corporation authorize activity both within and without the "excepted" fields (apparently it is the thought that the insurance field rather than insurance corporations is excepted from the Bankruptcy Act) and if the predominate business actually conducted lies in a field other than the excepted field, the corporation is not excluded from the Bankruptcy Act.

There is no Circuit Court of Appeals decision holding that the status of a corporation as an insurance, banking, municipal, railroad, or building and loan corporation, within the exclusion clause of Section 4 of the Bankruptcy Act, 11 U. S. C. A. 22, is to be determined by reference to corporate activities in addition to a consideration of charter powers. This is undoubtedly accounted for by the fact that the corporations in question, at least in modern times, are closely regulated, and conform to fairly uniform patterns with respect to charter powers denominating their business fields. This is certainly true in the case of life insurance corporations. Thus it may be said that in general corporations within the excepted classes are recognized as such by reason of the fact that their charter powers authorize certain activities. Consequently, when they engage in such activities the question as to whether their character is to be determined by their charter powers or by their activities is academic.

A case might possibly arise such as that referred to by way of illustration in *In re Supreme Lodge of the Masons Annuity*, 286 F. 180 (N. D. Ga. 1923), where an ancient railroad charter granted by the State of Georgia authorized the Georgia Railroad and Banking Company to conduct both a railroad and a banking business. If such a corporation were to do nothing under its charter other than to engage in the railroad business, could it be said to be a banking corporation? If such a case were to arise, then it might well be that cases such as *In re Roumanian Workers Educational Ass'n.*, 108 F. (2d) 782 (C. C. A. 6th, 1940), and *In re Kingston Realty Co.*, 160 F. 445 (C. C. A. 2d, 1908) dealing with the question as to what constitutes a moneyed, commercial or business corporation within the meaning of Section 4, and as to whether a corporation was principally engaged in the lines of endeavor which characterized the corporations subject to bankruptcy prior to the 1910 amendment, could be resorted to by way of analogy to deal with the situation. However, as we have said, no such case has yet found its way into a Circuit Court of Appeals in relation to the problem at issue and no such case is presented here, whether regard be had both to Fidelity's life insurance and annuity activities after January 1, 1941, or only to its life insurance activities after that day. The activities were those of a life insurance corporation both under the law of West Virginia and in the commonly accepted meaning of that term.

The argument in relation to a conflict between the decision of the Court in the present case and the decisions of other Circuit Courts of Appeal, by reason of the foregoing, necessarily points to the conclusion that the present decision is not in conflict with other decisions and that there

is no conflict even as among the other decisions when they are considered with respect to the facts involved.

**4. The point (petitioners' point No. 1) that the Investment Company Act of 1940 has classified corporations such as Fidelity as other than life insurance corporations**

*a. The point is not open here as it was not raised in the court below*

This point cannot afford any basis for issuance of the writ as it was not raised in the Circuit Court of Appeals and is therefore, except in extraordinary circumstances (none of which are shown), not open in this Court. *McGoldrick, etc. v. Compagnie Generale Transatlantique*, 309 U. S. 430, 60 S. Ct. 670, 84 L. ed. 849 (Mar. 25, 1940).

*b. In any event the point is without merit as Congress in the Investment Company Act of 1940 did not classify* GENERALLY *but expressly for the limited purposes of certain subsections of that Act and two sections of the Bankruptcy Act neither of which sections are germane to or involved in the case at bar*

Petitioners rest their whole point upon the assumption that the Investment Company Act of 1940 has classified corporations such as Fidelity as other than life insurance corporations and that where Congress has thus classified, for purposes of federal legislation, the federal courts should follow the classification so made. Such argument is entirely meaningless unless the classification involved is related to *purpose* of the classification. Stress is also laid upon the fact that the classification made by the Investment Company Act of 1940 was made for the purposes, among others, of the Bankruptcy Act. Here again, the argument is mean-

ingless unless it is related to such portions of the Bankruptcy Act as were affected by the classification.

It is true that in the Investment Company Act of 1940 Congress has created and defined the term "face amount certificate" 15 U. S. C. A. 80a-2 (a) (15)[1]. As so defined the term would include annuity contracts whether for life or for a stated period. The terms "investment company" and "face amount certificate company" are also created and defined by the Act. 15 U. S. C. A. 80a-3 (a) (2) and 15 U. S. C. A. 80a-4 (1).[2] As so defined a "face amount certificate company" which is a species of an investment company, would include all life insurance companies were it not for the exclusion made by 15 U. S. C. A. 80a-3 (c) (3)[3] and 80a-2 (a) (17)[4].

These sections define and exclude insurance companies from the definition of "investment companies" and "face amount certificate companies." As so defined and excluded, insurance companies are those whose primary and predominate business activity is the writing of insurance and which are subject to supervision by the insurance officials of the various states.

For what purpose are these classifications and definitions created? Each and every one of them are prefaced in the Investment Company Act by the express language, "When used in this subchapter and sections 72 (a), last sentence, and 107 (f) of Title 11." These are the *express* and *only* purposes subserved by these definitions in the Investment Company Act.

There can be no question but that the Investment Company Act of 1940 intended to regulate as "face amount

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[1]Printed in petitioners' brief, p. 20.
[2]Printed in petitioners' brief, pp. 20-21.
[3]See appendix this brief, pp. 67-68.
[4]Printed in petitioners' brief, pp. 22-23.

certificate companies," for the purpose of *that Act*, life insurance companies whose annuity business predominates over the writing of insurance risks, but in the light of the foregoing limited express purposes of these definitions, it is not perceived wherein any tenable argument can be advanced that the Congress in the Investment Company Act evidenced any intention to adopt a "definition" of an insurance company applicable *generally* to the administration of federal law and federal statutes. Quite to the contrary, as we have already pointed out, for purposes of taxation and for R. F. C. loans, no attempt is made to classify life insurance corporations upon the basis of the predominance of their activity as between writing annuities and life insurance policies. 26 U. S. C. A. 201 (a); 15 U. S. C. A. 605i.

As a matter of fact, under the definition of a life insurance company made for tax purposes by 26 U. S. C. A. 201 (a), an insurance company could do 95% of its business in annuity contracts and 5% in life insurance policies. No distinction is made whatsoever between the writing of insurance and the writing of annuities, so long as the reserve funds held for the fulfillment of either or both forms of contract comprise more than 50% of the total reserves.

There is but one conclusion that is possible with respect to the intention of Congress in classifying insurance companies. There is no such thing as a uniform congressional classification of life insurance companies. The definition varies *for the purposes* of particular acts. Such a company is one thing for taxation, another thing for R. F. C. loans, another thing for investment company regulation and possibly still another thing for purposes of other federal statutes.

The case at bar is concerned with the status of Fidelity as a corporation eligible to the benefits of the Bankruptcy Act. It is not concerned with Fidelity's status under the Investment Company Act. It is concerned only with whether Fidelity is an "insurance corporation" within the meaning of sec. 4 of the Bankruptcy Act (11 U. S. C. A. 22).[1] This section excludes insurance corporations and other named corporations from the provisions of the Bankruptcy Act. This section was not amended or even referred to in the Investment Company Act of 1940. As we have heretofore shown, pp. 28-34 this brief, there are certain recognized tests for determining whether a corporation is an insurance corporation within the exclusion clause of sec. 4 of the Bankruptcy Act. We have shown that under these tests Fidelity must be classified as an insurance company under this exclusion clause of the Bankruptcy Act. If the Congress was not content with these recognized legal tests for determining a corporation's status as an insurance company under this exclusion clause of the Act, it would have been a simple matter for it to have made its classifications and definitions in the Investment Company Act applicable to this exclusion clause of the Bankruptcy Act. The Congress had its attention specifically directed to the Bankruptcy Act and chose to amend that Act in two small particulars only, neither of which are germane to or involved in the case at bar.

Petitioners do not even assert that the exclusion clause (sec. 4 of the Bankruptcy Act) was impliedly amended by the Investment Company Act of 1940. It would do violence to every known rule of statutory construction to so assert as the Act upon its face shows that Congress had its atten-

[1] Appendix this brief, p. 64

tion directed to the Bankruptcy Act and deliberately chose to make its classification and definitions of significance in relation to bankruptcy only with respect to two named sections of that Act, namely secs. 72 (a), last sentence, and 107 (f) of Title 11.

The Investment Company Act of 1940 amended the Bankruptcy Act in two minor respects. It added the last sentence to sec. 72 (a) and sec. 107 (f) Title 11, U. S. C. A.[1] Sec. 107 (f) obviously is not applicable to Fidelity as it relates exclusively to deposits made by a face amount certificate company with a depository to secure the holder of any security sold by or on behalf of the debtor on or after January 1, 1941. In the case at bar, none of the states hold any such deposits. Furthermore, neither this section nor the last sentence of sec. 72 (a), Title 11 U. S. C. A., dealing with the appointment of a trustee for face amount certificate companies even purport to make *all* face amount certificate companies as defined in the Investment Company Act eligible for bankruptcy or to state in any way, shape or manner *what* "face amount certificate companies," as defined in the Investment Company Act of 1940, are eligible for bankruptcy.

Congress deliberately accepted the existing law as to what persons or corporations are eligible to the benefits of the Bankruptcy Act and made only two minor administrative changes in relation to administration of the assets of a "face amount certificate company" as defined in the Investment Act, if the company is otherwise eligible for and subject to the bankruptcy law. The Congress simply recognized that some "face amount certificate companies," as defined in the Investment Company Act, would be eligible

[1] Appendix this brief, pp. 64-66.

for and subject to the bankruptcy law and that some would not be. As to the former, the Congress made two minor changes in the administration of the estate of a bankrupt face certificate company. As to the latter, the Congress made no change. It is one thing to say that all "face amount certificate companies," as defined in the Act, may be adjudged bankrupts. It is another thing to say that all "face amount certificate companies" as defined in the Act which are eligible for and have been adjudicated bankrupts shall be administered in a certain way. The Congress deliberately elected the latter.

**5. The point (petitioners' point No. 2) that a federal question is presented which has not been but should be settled by this Court**

To some extent this contention is simply a restatement of other contentions which have been advanced under different headings. The petitioners claim, for example, that the Court should settle the questions because of conflict with decisions of other Circuit Courts of Appeal (which we have shown does not exist) and because of a conflict with the decisions of this Court relating to the administration of tax laws (which we have shown does not exist).

The only other basis which petitioners assert in their claim that the Court should determine a question which has not been and should be settled, is contained in the following extract from their brief:

> "Considering the variety of powers that are contained in the charters of the many corporations organized under the varying laws of the several States, the multiplicity of activities frequently engaged in by a single corporation, the differences in the laws of the several States relative to the issuance of corporate chart-

ers, together with the expanding field of Federal legislation, it is inevitable that questions of this general type will recur frequently. We believe that the principles of classification of corporations within the purposes of the Bankruptcy Act and especially the reorganization provisions thereof, Chapter X, should be settled by this Court." (Petitioners' brief, p. 25.)

It is a complete answer to the argument so advanced by petitioners that there is no such thing as a variety of powers contained in the charters of life insurance corporations under the laws of the several states. Neither is there a multiplicity of activities engaged in by life insurance companies under the laws of several states. There is a singular uniformity in the charter powers and activities of life insurance corporations provided for by the states of the United States and no decision which this Court could hand down could clarify the problem to any greater extent than it is now clarified. Every Circuit Court of Appeals decision, and so far as we know every District Court decision, construing Section 4 of the Bankruptcy Act, 11 U. S. C. A. 22, would agree that a life insurance corporation chartered to deal in life insurance and annuities under a state law providing for the incorporation of life insurance companies,—which is licensed as such, and which is engaged in the forms of enterprise authorized by its charter, is an insurance corporation.

It will be time enough for this Court to lay down a rule for the guidance of the bench and bar when a factual case is presented, indicating a need for such guidance. No such case is presented here.

## II. THE PETITION AND SUPPORTING BRIEF DISCLOSE NO GROUNDS FOR THE ISSUANCE OF A WRIT OF CERTIORARI TO REVIEW THE DETERMINATION OF THE CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT THAT FIDELITY'S PETITION FOR REORGANIZATION WAS NOT FILED IN GOOD FAITH

### A. The decision of the Circuit Court of Appeals that the prior proceedings pending in the state courts would best subserve the interests of creditors is a determination based upon an examination and appraisal of the facts in this particular case

Section 146 of Chapter 10, 11 U. S. C. A. sec. 546, insofar as material to this point, provides:

> "Without limiting the generality of the meaning of the term 'good faith', a petition shall be deemed not to be filed in good faith if—
>
> "(1) * * *
>
> "(2) * * *
>
> "(3) * * *
>
> "(4) a prior proceeding is pending in any court and it appears that the interests of creditors and stockholders would be best subserved in such prior proceeding."

The determination of the Circuit Court of Appeals for the Fourth Circuit under subsection (4) of Section 146 that the proceedings instituted in the state courts of West Virginia and elsewhere would best subserve the interests of creditors is a conclusion arrived at upon examination of questions of fact in this case. The Circuit Court of Appeals, of course, had no occasion to inquire as to which

proceedings would best subserve the interests of Fidelity's stockholders because, as stated in the petition for reorganization and as fully conceded by all parties in the case, Fidelity is wholly insolvent in any sense of the word and the stockholders have no equity whatever to be dealt with in any form of proceedings.

It should be further borne in mind that, as both the Circuit Court of Appeals and the District Court found, there is no reasonable prospect of the company being reorganized as a going concern, but, as stated by the Circuit Court of Appeals (R. 383), "only the immediate need of a liquidation of the company's assets for the benefit of the contract holders." At the argument in the Circuit Court of Appeals it was freely conceded by counsel for the Securities and Exchange Commission that the chances were practically 100% against Fidelity's ever being reorganized as a going concern.

As stated in petitioners' brief herein, Fidelity's aggregate assets amount to, in round figures, $21,100,000. Of these total assets, $20,056,680.27 consist of securities on deposit with the states, $556,467.51 in undeposited securities, and approximately $500,000 in cash (R. 366). The remaining assets consist of the home office building at Wheeling, West Virginia and several parcels of real estate of small value in relation to the value of the deposited securities. It may be safely said that Fidelity's assets are from 95 to 98 per cent composed of the securities on deposit with the states.

The sole question which the Circuit Court of Appeals had for determination under subsection (4) of Section 146 was whether or not, in view of the purpose to be accomplished, that is, the sale of the deposited securities,

and the distribution of the cash proceeds to the contract holders as their respective rights thereto might appear, the interests of such contract holders would be best subserved by the continuance of the state court proceedings already commenced under the statutes of the various states expressly adapted to that purpose.

This court has frequently held that it will not grant certiorari to review determinations of fact or determinations of fact and law grounded upon factual considerations.

*Southern Power Co. v. North Carolina Public Service Commission*, 263 U. S. 508, 44 S. Ct. 164, 68 L. ed. 413 (1924);

*United States v. Johnston*, 268 U. S. 220, 45 S. Ct. 496, 69 L. ed. 925 (1925);

*Houston Oil Co. of Texas v. Goodrich*, 245 U. S. 440, 38 S. Ct. 140, 62 L. ed. 385 (1918);

*Charleston S. C. Mining & Mfg. Co. v. United States*, 273 U. S. 220, 47 S. Ct. 349, 71 L. ed. 618 (1927).

This rule has been uniformly adhered to by the denial of writs of certiorari in cases where the writ was sought to review determinations upon the issue of good faith in Section 77B proceedings.

*First National Bank v. Conway Road Estates Co.*, 94 F. (2d) 736 (C. C. A. 8th, 1938) (reversing District Court on the issue of good faith in 77B proceedings); cert. den. 304 U. S. 578, 58 S. Ct. 1047, 82 L. ed. 1541;

*Price v. Spokane Silver and Lead Co.*, 97 F. (2d) 237 (C. C. A. 8th, 1938) (reversing District Court on issue of good faith in 77B proceed-

ings); cert. den. 305 U. S. 626, 59 S. Ct. 88, 83 L. ed. 401;

*In re Mount Forest Fur Farms of America*, 103 F. (2d) 69 (C. C. A. 6th, 1939) (sustaining District Court on issue of good faith in 77B proceedings); cert. den. 308 U. S. 583, 60 S. Ct. 105, 84 L. ed. 488.

**B. No principles as to the application of subsection (4) of Section 146 of Chapter 10 to control in future cases would result by a review in this Court of the decision of the Circuit Court of Appeals on this point.**

Petitioners seek to draw some parallel between the present case and the case of *In re Marine Harbor Properties*, 125 F. (2d) 296 (C. C. A. 2nd, 1942), in which certiorari was granted in 86 L. ed. (adv.) 729. They suggest that in the *Marine Harbor* case the same question as to good faith is involved as in this case, and that because in the *Marine Harbor* case properties situated in only one state were involved and because in this case properties situated in a number of states are involved, that the disposition of the *Marine Harbor* case in this Court will not determine the principles involved in this case. We are in full accord with petitioners' views that the decision in the *Marine Harbor* case will determine no principles apropos of this case, not, however, for the reason that in the *Marine Harbor* case the properties were situated only in one state, but for the reason that the question of law decided by the Circuit Court of Appeals in the *Marine Harbor* case bears no resemblance whatsoever to the question decided in this case under the provisions of subsection (4) of Section 146 of Chapter 10. The Circuit Court of Appeals in the *Marine Harbor* case

distinctly pointed out (125 F. (2d) 299) that the reason it dismissed the petition for lack of good faith was not for the reason expressed in subsection (4) of Section 146 but for "a special instance of a lack of good faith flowing from the personal disqualification of the debtor." The court in that case followed its decision in *Brooklyn Trust Co. v. Rembaugh*, 110 F. (2d) 838 (C. C. A. 2nd, 1940), the rationale of the case being fully expressed in its opinion as follows (125 F. (2d) 299):

> "A majority of the court is of the opinion that the Rembaugh case should be given effect here to prevent a debtor, who has assented to a plan which is being supervised by the state court in reorganization proceedings still pending there, from flouting that jurisdiction by filing a petition in the district court. The applicable principle, as was said in the Rembaugh case, is not an absence of good faith in the filing of the new petition in the broad meaning of those words but a special instance of a lack of good faith flowing from the personal disqualification of the debtor. Section 146, 11 U. S. C. A. sec. 546, expressly disclaims any limitation upon the generality of the meaning of good faith and *subsection 4 of that section is but one special instance of what will show a disabling absence of it on the part of a debtor and is not to be confused with what controls here.* * * *" (Emphasis supplied)

The case of *In re Paloma Estates*, 126 F. (2d) 72 (C. C. A. 2nd, 1942) for review of which petitioners state a petition for certiorari has been filed, is somewhat similar to this case since the petition was dismissed because the court found that the prior proceedings would best subserve the interests of creditors within the meaning of subsection (4) of Section 146 of Chapter 10. Judge Clark, dissenting in that case, suggested that since the court had only affi-

davits before it and no real evidence, a more searching inquiry should have been made. Judge Clark also felt that the District Court which was affirmed by the Circuit Court had laid undue stress on the estoppel of the debtor under the doctrine of the *Rembaugh* case. In the *Marine Harbor* case, Judge Frank, dissenting, pointed out that where stockholders have no equity, under subsection (4) of Section 146 stress should be placed upon the interests of creditors.

Regardless of the merits of the "debtor estoppel" theory which was the basis of the Circuit Court of Appeals decision in the *Marine Habor* case and which was the basis, in part, of Judge Clark's dissenting opinion in the *Paloma Estates* case, we are in the fullest accord with the statements of each of these dissenting judges that under subsection (4) of Section 146 a searching inquiry should be made and the evidence fully developed to determine which proceedings are in the best interests of creditors. There can be no question in the present case that all of the facts in this regard were fully and exhaustively explored in the protracted hearing and that such facts were fully and exhaustively considered by the Circuit Court of Appeals in arriving at its determination under subsection (4) of Section 146 that the state court proceedings would best subserve the interests of creditors under the circumstances of this case.

It is idle to suggest that a review by this Court of the determination of the Circuit Court of Appeals as to which type of proceedings will best subserve the interests of creditors under subsection (4) of Section 146, made after the fullest possible presentation and review of the facts bearing upon this determination, will serve to lay down any guiding principles for future cases where the facts will inevitably be widely divergent from the facts in the case at hand.

Petitioners also quote language from the opinion in *In re National Surety Co.*, 7 F. Supp. 959 (D. C., N. Y., 1934) as being apposite here. Suffice to say that in that case the assets securing the company's debts did not consist of negotiable securities deposited with state authorities which only remain to be sold and the proceeds distributed in order that the creditors may have the fullest possible benefit therefrom.

### C. The Circuit Court of Appeals did not decide that reorganization within the meaning of subsection (3) of Section 146 of Chapter 10 excluded a "slow and orderly liquidation"

Petitioners in their brief ask the question: "Does the record show that it is unreasonable to expect that a plan of reorganization can be effected?" By propounding such query petitioners seem to indicate their belief that the Circuit Court of Appeals predicated its decision in this case on subsection (3) of Section 146 of Chapter 10 wherein it is provided that a petition shall not be deemed filed in good faith if "it is unreasonable to expect that a plan of reorganization can be effected." Petitioners then suggest that a factual inquiry should be made by this Court as to such matters, and then assert the claim that the Circuit Court of Appeals entertained as its concept of reorganization as used in subsection (3) of Section 146 the concept that it must be shown in order to avoid dismissal of the petition thereunder that Fidelity can be rehabilitated as a going concern carrying on its business in substantially the same manner as it had previously done.

If the Circuit Court of Appeals had in any way predicated its decision upon subsection (3) of Section 146, we might reasonably inquire whether this Court would be

moved to grant certiorari to examine the multitudinous facts and circumstances bearing upon petitioners' propounded question. However, the Circuit Court of Appeals did not rest its determination that the petition should be dismissed upon subsection (3) of Section 146 but solely upon the provisions of subsection (4) of Section 146. The Circuit Court of Appeals did state in its opinion (R. 383):

> "* * * We think it is our duty to review the situation realistically, and when this is done there appears to be no reasonable hope of a reorganization of the business as a going concern, but only the immediate need of a liquidation of the company's assets for the benefit of the contract holders. Obviously there will be nothing left for these stockholders."

Examination of the District Court's opinion reveals that it in effect also held it was not reasonable to expect that Fidelity could be reorganized as a going concern. The Circuit Court of Appeals further said in its opinion (R. 384):

> "* * * The facts underlying the whole situation are so clear that even the parties in this case who insist upon reorganization under the Bankruptcy Act hold out little hope of a resumption of the business as a going concern, and content themselves for the most part with the argument that reorganization in the statutory sense includes 'a slow and orderly liquidation.'
>
> "But, it is said that even if liquidation is inevitable, the interests of creditors would be best served by a retention of the case in the federal court * * *."

The Circuit Court of Appeals then went on to demonstrate and find that the interests of creditors would in fact, under the circumstances here present, best be subserved by the prior proceedings in the state courts, the entire de-

termination being predicated solely upon the grounds set forth in subsection (4) of Section 146. The Circuit Court of Appeals did not in any way express an opinion as to the merits of petitioners' contentions that the claimed possibility of a "reorganization" being effected in the federal court by means of some unspecified type of "slow and orderly liquidation" would be sufficient under subsection (3) of Section 146 to sustain the federal proceedings.

Petitioners, upon the assumption that the Circuit Court of Appeals has in some way expressed itself as opposed to their contentions in this regard, cite a number of cases where in federal reorganization proceedings plans of reorganization were adopted providing for the formation of holding companies to liquidate the debtor's assets over a long period of time for the benefit of creditors, these cases being:

*In re Central Funding Corp.*, 75 F. (2d) 256, 259 (C. C. A. 2nd, 1935);

*In re Mortgage Securities Corp.*, 75 F. (2d) 261 (C. C. A. 2nd, 1935);

*Continental Insurance Company v. Louisiana Oil Refining Corp.*, 89 F. (2d) 333, 336 (C. C. A. 5th, 1937);

*R. L. Witters Associates v. Ebsary Gypsum Company*, 93 F. (2d) 746, 748 (C. C. A. 5th, 1938);

*In re Porto Rican American Tobacco Company*, 112 F. (2d) 655, 657 (C. C. A. 2nd, 1940);

and another case is cited which holds that under Section 77B the organization of a successor corporation was not without the purview of reorganization plans thereunder:

*Capital Endowment Company v. Kroeger*, 86 F. (2d) 976, 979 (C.C.A. 6th, 1936).

Whatever might have been done in such cases, the Circuit Court of Appeals concluded that for the purpose of what is to be done in this case, namely, the sale of negotiable securities and the distribution of the proceeds thereof to creditors, dismissal of the petition was required under the provisions of subsection (4) of Section 146. The decision of the Circuit Court of Appeals upon the good faith question in this case rests solely upon that subsection.

**D. The conclusion of the Circuit Court of Appeals is obvious under the facts and a review of its decision would serve only to prolong needless litigation to the irreparable damage of contract holders**

Petitioners have never in this case challenged in the slightest degree the validity of the state laws under which securities were deposited in trust for the benefit of creditors in each of the respective states in order that Fidelity might be permitted to carry on its business there. Indeed, to do so would be wholly futile since such laws are common, of long standing and are uniformly held valid and effective.

See:

*United States v. Knott*, 298 U. S. 544, 56 S. Ct. 902, 80 L. ed. 1321 (1936);

*Blake v. McClung*, 172 U. S. 239, 19 S. Ct. 165, 43 L. ed. 432 (1898) (particularly at 172 U. S. 257);

23 Am. Jur. 271;

23 Am. Jur. 467.

Petitioners, we are gratified to note, appear to concede that the interests of Wisconsin creditors will be best subserved by a liquidation of the Wisconsin securities in Wisconsin. They also state that there is a substantial surplus of assets held in Wisconsin over contract liabilities to residents of that state and also surpluses in certain other states. We should point out that this is a wholly incorrect statement for the reason that the deposit in Wisconsin and in certain other states exceeds only what is known as the "net cash liability" in those states on Fidelity's outstanding contracts. When it is borne in mind that contract holders had to make monthly payments for a period of eleven months or one year before there was any "net cash liability" on such contracts, it may be readily appreciated that the actual liability of Fidelity to contract holders in any particular state is in no way measured by "net cash liability." The Circuit Court of Appeals correctly relegated such contentions to the realm of "possibilities without substantial showing" (R. 385).

This case is in no sense a case where a debtor in need of rehabilitation is being denied relief under Chapter 10 needful and beneficial both to itself and its creditors. Instead, the sole question presented is whether the Central Trust Company in Charleston, West Virginia should liquidate and distribute the trust funds set up and administered in the various states for many years, or whether the state authorities to whom the contract holders have always looked shall perform that function.

We must point out that throughout the entire proceedings the federal trustee took a position of extreme hostility toward those creditors represented in person and represented by state authorities who opposed the so-called

reorganization proceedings. The trustee now complains that it has not had time, due to this litigation, to formulate proposed plans of reorganization.

It was not proper for the trustee to occupy itself in this litigation. Under Section 77B it was held that a trustee appointed in such proceedings was not concerned with the merits of the petition or its dismissal. *Loomis v. Gila Co.*, 101 F. (2d) 827 (C. C. A. 9th, 1939); petition for re-hearing den. 103 F. (2d) 312; cert. den. 307 U. S. 643, 59 S. Ct. 104, 83 L. ed. 1524. Indeed, it is our understanding that one of the prime purposes of the passage of Chapter 10 was to insure a disinterested trustee. Vigorous objection was made during the hearing to the trustee's participation on behalf of those who desired the continuance of the federal proceedings (T. 65, 77, 3615, 3625). We contend upon the same considerations as moved us then that the federal trustee has no proper place as a petitioner for certiorari in this court.

It must further be noted that of the debtor's present counsel two, namely John V. Ray and Homer A. Holt, are regularly employed as counsel for the Central Trust Company, the federal trustee. As was pointed out to the Circuit Court of Appeals, the law firm of Mr. John V. Ray is "general counsel" for Central Trust Company, and Mr. Holt disclosed at the bar of the Circuit Court of Appeals in connection with the application for stay of mandate that his law firm was also regularly employed as counsel by Central Trust Company and had in fact been consulted by it in its private interest during the course of the present proceedings in matters affecting those proceedings. Mr. James R. Fleming, who originally filed the petition on the part of debtor, withdrew on September 17, 1941 during the

course of the hearing on the answers controverting the debtor's petition, and has taken no active part in any of the proceedings since that time. Mr. Ray's first appearance was on September 17, 1941 and Mr. Holt's first appearance was on the application for stay of mandate in the Circuit Court of Appeals.

If we understand the provisions of Sections 156, 157 and 158 of Chapter 10 correctly, the position of the trustee in this case does not square with the standards therein set forth.

After the interests of contract holders in Wisconsin and Iowa and elsewhere have been for years looked after at public expense and deposits have been made to secure their contracts, the Central Trust Company of Charleston, West Virginia now steps forward professing concern and anxiety for the interests of Fidelity's creditors. It insists that it, and not the state authorities, shall liquidate the deposited assets and distribute the proceeds. It must be pointed out that none of the state authorities complied with the ex-parte turn-over orders entered by the District Court on June 6th and June 19th, 1941, which orders were later rescinded under date of August 9, 1941. We are not as yet quite sure whether the federal trustee contemplates conducting a so-called re-organization proceeding without benefit of possession and control over the assets of the company, practically all of which are in the hands of the state authorities as trust deposits. Perhaps if on some theory the petition for reorganization were ultimately sustained, it would contemplate suits of some type to secure possession of these assets. This would, of course, have the effect of endlessly prolonging the litigation in connection with the purported federal reorganization proceedings and,

as does the prosecution of the present petition, would further jeopardize the interests of Fidelity's contract holders by subjecting the securities securing their contracts to the risk of further depreciation in the unsettled markets of today.

In states such as Wisconsin and Iowa where the remaining deposited securities are of the highest grade and readily salable, it would seem fantastic, as it must have seemed to the Circuit Court of Appeals, to suggest that the contract holders secured by such deposits could be benefited by a "slow and orderly liquidation" in federal court. With respect to such securities what is obviously needed is a *speedy* and orderly liquidation. In states where the type of assets on deposit dictates another course, we must assume, as did the Circuit Court of Appeals, that such states will adopt the method of liquidation best suited to produce the most for contract holders.

Petitioners propose that the more than six thousand contract holders in Wisconsin and Iowa, whose interests have up to the present time been diligently looked after by the state authorities, shall now be thrown upon their own devices and presumably shall retain counsel to press their claims against the assets deposited in trust for their benefit in Wisconsin and Iowa in the far-off District Court in Charleston, West Virginia.

These facts all point to the correctness of the decision of the Circuit Court of Appeals that the interests of creditors would be best subserved in the prior state proceedings and that the granting of a writ of certiorari in this case would only serve to continue the period of speculation and hazard to which the contract holders are presently being subjected.

**E. The determination of the rights of contract holders in the trust funds securing their contracts in the various states is exclusively a question of state law to be determined by the state courts, and the state court proceedings should not be further delayed**

It is likely, as suggested by petitioners, that questions will arise as to the respective rights of contract holders in any one state as to their proper share of the trust funds in that state. The deposit laws of Wisconsin and Iowa and the other states are a part of a complete scheme for the supervision of corporations of Fidelity's type in each of these states. The trusts created in the respective states by these laws are for the benefit of resident creditors therein. The right of any contract holder in Wisconsin or Iowa to a share in the fund there is necessarily a question of Wisconsin or Iowa law. The deposits have been and are located in Wisconsin and Iowa. Were this proceeding to be continued in the federal court, recent decisions of this court would indicate that the federal court would be required to submit questions as to the construction of the Wisconsin, Iowa and other state laws not yet decided by the courts of these states to the state courts. *Thompson v. Magnolia Petroleum Co.*, 309 U. S. 478, 60 S. Ct. 628, 84 L. ed. 876 (1940).

In fact, although the Circuit Court of Appeals in this case made no decision upon this point, it may be forcefully contended that where state authorities assert jurisdiction under statutes such as involved here, the federal court should dismiss the petition on this ground alone. See *Pennsylvania v. Williams*, 294 U. S. 176, 55 S. Ct. 380, 79 L. ed. 841 (1935); and as cited in *Securities and Exchange Commission v. United States R. & Imp. Co.*, 310 U. S. 434, 60

S. Ct. 1044, 84 L. ed. 1293 (1940), to the effect that its principles are imported into the application of the Chandler Act by the federal courts.

See also:

*Gordon v. Ominsky*, 294 U. S. 186, 55 S. Ct. 391, 79 L. ed. 848 (1935);

*Penn General Casualty Co. v. Pennsylvania*, 294 U. S. 189, 55 S. Ct. 386, 79 L. ed. 850 (1935);

*Kelleam v. Maryland Casualty Co.*, 312 U. S. 377, 61 S. Ct. 595, 85 L. ed. 899 (1941).

The principle of *Railroad Commission of Texas v. Pullman Co.*, 321 U. S. 496, 61 S. Ct. 643, 85 L. ed. 971 (1941), is, we believe, also closely related to the principles expressed in the foregoing cases and to the principles involved in this case. As said in the opinion there (321 U. S. 500):

> "* * * Few public interests have a higher claim upon the discretion of a federal chancellor than the avoidance of needless friction with state policies; * * * This use of equitable powers is a contribution of the courts in furthering the harmonious relation between state and federal authority without the need of rigorous congressional restriction of those powers. * * *"

If it is proper and necessary for the state courts in any event, as we believe it is, to determine the application of their particular state laws to the trust deposit of debtor's assets located in such states and the sole purpose of the federal proceeding is a liquidation of some sort, then it is clear that the federal proceedings are only duplicitous and unnecessary, and there can be no possible quarrel with the decision of the Circuit Court of Appeals that the prior proceedings best subserve the interests of Fidelity's creditors.

## III. THE PETITION SHOULD BE DISMISSED FOR FAILURE ON THE PART OF PETITIONERS TO PRINT AND SERVE A RECORD IN COMPLIANCE WITH THE RULES OF THIS COURT

The petitioners have served us with what purports to be a printed record of this case but which in fact contains only a fragmentary part of the record and much material which is not of record. The abridgement which has been served upon us consists of the appendices attached to the briefs in the Circuit Court of Appeals plus the proceedings in that court including the opinion.

Under the rules of the Circuit Court of Appeals for the Fourth Circuit the original stenographic transcript made by the court reporter in the District Court is filed, as are the pleadings, exhibits and other matter of record. Parties to an appeal may place in the appendices of their briefs such portions of the testimony and such exhibits as they desire to call to the attention of the court in original form. Other matters, such as statutes relied upon in the argument, may also be placed in the appendices. The printing of an appendix is entirely optional and may be dispensed with if desired, and two of the parties, namely, the trustee and the Missouri appellant, printed no appendices to their briefs filed in the Circuit Court of Appeals.

It is not necessary that testimony be set out in an appendix to a brief filed in the Circuit Court of Appeals for the Fourth Circuit. Under the rules references may be made to the original transcript where no particular stress is desired with respect to the exact context of testimony. In preparing the Wisconsin and Iowa brief for the Circuit Court of Appeals it was not felt that the case was suited

to extensive use of quoted testimony in the appendix and consequently our appendix contained no testimony. It contained the opinion of the District Court, one of the exhibits filed in the case and statutes of the states of Wisconsin and Iowa and other states, to which reference was made in the argument.

Some of the other briefs, however, contained excerpts of the testimony found in the original transcript. Many of these excerpts have no particular significance except in connection with the briefs to which they were attached and in which reference thereto was made. Moreover, a great part of the material found in the various appendices relates to questions raised by certain of the parties in the Circuit Court of Appeals but which were not decided by that Court.

It may be fairly said that aside from such references to the testimony as are made in the opinions of the District Court and the Circuit Court of Appeals, there is very little factual material contained in the record which has been served upon us, which is of the least assistance in determining the issues raised upon the petition for certiorari. Such matter as is presented upon these issues in the record as printed by petitioners is for the most part matter which was included in the appendix to the debtor's brief filed in the Circuit Court of Appeals in support of its position there. It is thus one sided. The fact that respondents chose to print very little of the evidence upon these issues in their appendices thus operates to their disadvantage under the scheme petitioners have adopted as to the record. In fact, petitioners in the printed record submitted here have failed to print in its entirety the matter contained in the appendix to the Wisconsin brief filed in the Circuit Court of Ap-

peals. Page 65 of that appendix, containing a schedule of securities liquidated in Wisconsin prior to the commencement of the federal proceedings and showing the prices obtained therefor, is for some reason omitted completely. We may also note that the so-called record does not even contain the pleadings in the case.

So far as we are advised, no respondents other than the Wisconsin and West Virginia respondents and possibly Maryland are in possession of a copy of the original stenographic transcript of the testimony taken in the District Court. None of the respondents are in possession of the exhibits in the case, of which there were 123, some of them consisting of hundreds of pages. Speaking for ourselves, we can say that we have been handicapped in the preparation of our brief by the failure of the petitioners to prepare and serve an adequate record, and we can well sympathize with the position of those respondents who do not even have a copy of the transcript of testimony in the District Court.

As we understand Rule 38 of this Court, where a record has not been printed for the use of the court below, as is the case here, a petitioner for certiorari must print the complete record in the case and serve it upon the respondents within the period prescribed by Section 8 of the Act of February 13, 1925 (28 U. S. C. A., sec. 350), or, if it is desired to omit from the printed record matter not essential to a consideration of the questions presented by the petition for the writ, a stipulation should be entered into between counsel for the omission of such matter. No such stipulation has been entered into in this case, although the Wisconsin respondent advised counsel for petitioners by

telegraph on July 27, 1942 that the Wisconsin respondent would expect to be consulted directly by petitioners if any abridgement of the record were contemplated. We have received no acknowledgment, direct or indirect, of our telegram, and we have not been approached at any time for a statement of our views as to what the record should contain. We may say further that we have been advised that other respondents have likewise been completely ignored with respect to any views which they might have in the preparation of a record.

Rather than printing a complete record or approaching the respondents with a view to obtaining a satisfactory abridgement by stipulation, counsel for the petitioners have proceeded to print the fragmentary record with which we have been served and have also served us with a copy of a motion addressed to this Court asking that the petition for certiorari be considered upon the basis of the record printed by them.

It is our view that the motion is not timely. By the time it can be considered the time for filing respondents' opposing briefs will have expired and the time in which petitioners are permitted to file their petition, including a copy of the printed record, will have expired.

We would also oppose petitioners' motion, if in fact it is to be considered by this Court, for the reason, as we have already stated, that the printing of appendices to certain of the briefs filed in the Circuit Court of Appeals does not with any degree of completeness place before this Court and in the hands of these respondents a record of the evidence material to a consideration of the petition for the writ upon the questions decided by the Circuit Court of

Appeals. Had petitioners evinced a desire to stipulate as to the record, we feel quite certain that such portions of the record as are material to a consideration of the petition could have been printed and would not have exceeded in length or cost the material which petitioners have printed as the record on the petition.

The creditors have been put to additional and unnecessary expense by the printing of a record consisting for the most part of matters wholly irrelevant to a consideration of the petition upon the questions decided by the Circuit Court of Appeals, and have likewise been prejudiced in the presentation of their position in opposition to the writ. Under the circumstances we believe petitioners' motion must be denied and the petition should be dismissed for failure to have the record printed and served in accordance with the rules of this Court.

## CONCLUSION

Upon the foregoing considerations it is respectfully submitted that the petition for a writ of certiorari to the Circuit Court of Appeals for the Fourth Circuit should be denied.

Respectfully submitted,

JOHN E. MARTIN,
*Attorney General, State of Wisconsin,*

JAMES WARD RECTOR,
*Deputy Attorney General, State of Wisconsin,*

RICKARD H. LAURITZEN,
*Assistant Attorney General, State of Wisconsin,*
*Attorneys for Respondent,*
*Banking Commission of Wisconsin.*

JOHN M. RANKIN,
*Attorney General, State of Iowa,*

FLOYD PHILBRICK,
*First Assistant Attorney General, State of Iowa,*

CARL J. STEPHENS,
BEN C. BUCKINGHAM,
*Attorneys for Respondent,*
*Charles R. Fischer,*
*Commissioner of Insurance and Permanent Receiver for Debtor Corporation In and For the State of Iowa.*

# APPENDIX

## 11 U. S. C. A., sec. 22:

"(a) Any person, except a municipal, railroad, insurance, or banking corporation, shall be entitled to the benefits of this title as a voluntary bankrupt.

"(b) Any natural person except a wage earner or a person engaged chiefly in farming or the tillage of the soil, any unincorporated company, and any moneyed, business, or commercial corporation, except a municipal, railroad, insurance, or banking corporation, owing debts to the amount of $1,000 or over, may be adjudged an involuntary bankrupt upon default or an impartial trial, and shall be subject to the provisions and entitled to the benefits of this title.

"* * *"

## 11 U. S. C. A., sec. 72a:

"a. The creditors of a bankrupt, exclusive of the bankrupt's relatives or, where the bankrupt is a corporation, exclusive of its stockholders or members, its officers, and the members of its board of directors or trustees or of other similar controlling bodies, shall, at the first meeting of creditors after the adjudication, or after a vacancy has occurred in the office of trustee, or after an estate has been reopened, appoint a trustee or three trustees of such estate. If the creditors do not appoint a trustee or if the trustee so appointed fails to qualify as herein provided, the court shall make the appointment. If the bankrupt is a face-amount certificate company, as defined in section 80a-4 of Title 15, the court alone shall make the appointment; but the court shall not make such appointment without first notifying the Securities and Exchange Commission and giving it an opportunity to be heard."

11 U. S. C. A., sec. 107 (f):

"(f) (1) For the purposes of, and exclusively applicable to, this subdivision f (a) 'debtor' shall mean a face-amount certificate company as defined in section 80a-4 of Title 15; (b) 'face-amount certificate' shall mean a face-amount certificate as defined in section 80a-2 of Title 15; (c) 'depositary' is a person or State agency with whom securities or other property of a debtor is deposited or to whom property of a debtor is transferred, in trust or otherwise, pursuant to the requirements of a State law or an agreement by the debtor providing for the distribution of such property or its proceeds to creditors or security holders of the debtor in the event of the insolvency of the debtor or under other specified circumstances; (d) 'deposit creditor' is a creditor who, under the provisions of a State law or agreement providing for a deposit with or transfer to a depositary, has rights as to the securities or property so deposited or transferred which exceed the rights of a general creditor; and (e) 'State agency' is an official or agency of a State designated to act as depositary or to distribute property, or the proceeds of property held by a depositary.

"(2) Every deposit or transfer of securities or other property made by or on behalf of a debtor with or to any depositary for the benefit or protection of or to secure the holder of any security sold by or on behalf of the debtor on or after January 1, 1941, shall be voidable as against the trustee of such debtor if the property of the estate is insufficient for the full payment and discharge of all claims on account of all face-amount certificates sold by or on behalf of the debtor, and such deposit or transfer and every lien created thereby shall thereupon be avoided by the trustee subject to the provisions of paragraph 3 of this subdivision f.

"(3) In the event any deposit or transfer described in paragraph 2 of this subdivision f shall be avoided the trustee shall segregate the property received by the trustee from the depositary and charge the same with the costs and expenses of maintenance and liquidation and distribute the net proceeds thereof to the creditors who would have been entitled thereto under the provisions of the law or agreement providing for the deposit or transfer of the property, and each such creditor shall thereafter be entitled to dividends from the estate only after all creditors of the same rank shall have received the same percentage.

"(4) The court shall have summary jurisdiction of any proceedings to hear and determine the rights of any parties under this subdivision f and to hear and determine the sufficiency of the property of the estate for the full payment and discharge of all claims on account of all face-amount certificates sold by or on behalf of the debtor. Due notice of any hearing in such proceedings shall be given to every depositary and State agency which is a party in interest.

"(5) Where the provisions of subsection (c) of section 28 are not applicable, the provisions of this section will not apply."

11 U. S. C. A., sec. 506 (3):

"For the purposes of this chapter, unless inconsistent with the context—

"* * *

"(3) 'corporation' shall mean a corporation, as defined in this title, which could be adjudged a bankrupt under this title, and any railroad corporation excepting a railroad corporation authorized to file a petition under section 205 of this title;"

**11 U. S. C. A., sec. 544:**

"If an answer filed by any creditor, indenture trustee, or stockholder shall controvert any of the material allegations of the petition, the judge shall, as soon as may be, determine, without the intervention of a jury, the issues presented by the pleadings and enter an order approving the petition, if satisfied that it complies with the requirements of this chapter and has been filed in good faith and that the material allegations are sustained by the proofs, or dismissing it if not so satisfied."

**11 U. S. C. A., sec. 546:**

"Without limiting the generality of the meaning of the term 'good faith', a petition shall be deemed not to be filed in good faith if—

"(1) * * *

"(2) * * *

"(3) it is unreasonable to expect that a plan of reorganization can be effected; or

"(4) a prior proceeding is pending in any court and it appears that the interests of creditors and stockholders would be best subserved in such prior proceeding."

**15 U. S. C. A., sec. 80a-3 (c) (3):**

"(3) * * *

"(c) Notwithstanding subsections (a) and (b), none of the following persons is an investment company within the meaning of this subchapter and sections 72(a) last sentence, and 107 (f) of Title 11:

"(1) * * *

"(2) * * *

"(3) Any bank or insurance company; * * *"

**15 U. S. C. A., sec. 605i:**

"As used in sections 605e to 605j the term 'insurance company' shall include any corporation engaged in the business of insurance or in the writing of annuity contracts, irrespective of the nature thereof, and operating under the supervision of a State superintendent or department of insurance in any of the States of the United States. As used in this section and in sections 605e, 605f, and 605g of this title, the term 'State' means any State, Territory, or possession of the United States, the Canal Zone, and the District of Columbia:"

**26 U. S. C. A., sec. 801 (a):**

"(a) Definition. When used in this chapter the term 'life insurance company' means an insurance company engaged in the business of issuing life insurance and annuity contracts (including contracts of combined life, health, and accident insurance), the reserve funds of which held for the fulfillment of such contracts comprise more than 50 per centum of its total reserve funds."

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IN THE

# Supreme Court of the United States

OCTOBER TERM, 1942.

No. 319

FIDELITY ASSURANCE ASSOCIATION, A CORPORATION, DEBTOR, AND
CENTRAL TRUST COMPANY, TRUSTEE FOR FIDELITY ASSURANCE ASSOCIATION,

*Petitioners,*

*vs.*

EDGAR B. SIMS, AUDITOR OF THE STATE OF WEST VIRGINIA, AND EX OFFICIO INSURANCE COMMISSIONER OF THE STATE OF WEST VIRGINIA;
ROSS B. THOMAS AND H. ISAIAH SMITH, WEST VIRGINIA STATE COURT RECEIVERS;
BANKING COMMISSION OF WISCONSIN;
CHARLES R. FISCHER, COMMISSIONER OF INSURANCE AND PERMANENT RECEIVER FOR DEBTOR CORPORATION IN AND FOR THE STATE OF IOWA;
JOHN B. GONTRUM, INSURANCE COMMISSIONER OF THE STATE OF MARYLAND;
DEWEY S. GODFREY, MISSOURI STATE COURT RECEIVER;
L. H. BROOKE, TRUSTEE, FREDERICK LEAKE AND A. L. GOLDBERG, JR.;
SECURITIES AND EXCHANGE COMMISSION,

*Respondents.*

## BRIEF OF RESPONDENT, JOHN B. GONTRUM, INSURANCE COMMISSIONER OF THE STATE OF MARYLAND, IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT.

H. VERNON ENEY,
GUY B. BROWN,
Counsel for Respondent, John B. Gontrum, Insurance Commissioner of Maryland.

The Daily Record Co. Print, Baltimore.

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IN THE

# Supreme Court of the United States

OCTOBER TERM, 1942.

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FIDELITY ASSURANCE ASSOCIATION, A CORPORATION, DEBTOR, AND
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### OPINIONS BELOW.

The opinion of the District Court is printed in the record (R. 3-38) and is reported in 42 Fed. Supp. 973. The opinion of the Circuit Court of Appeals is also printed in the record (R. 363-388) and is reported in 129 Fed. (2d) 442 (Adv. Sheets).

## JURISDICTION.

The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended, (U. S. Code, Title 28, Sec. 347 (a)), and Section 24 (c) of the Bankruptcy Act (U. S. Code, Title 11, Sec. 47 (c)). The decree of the Circuit Court of Appeals was entered on June 16, 1942 (R. 387-388). A petition for rehearing was filed on July 13, 1942 (R. 389-396) and was denied on July 22, 1942 (R. 397).

## STATEMENT OF THE CASE.

On June 6, 1941, Fidelity Assurance Association filed in the United States District Court for the Southern District of West Virginia a voluntary petition for reorganization under Chapter 10 of the Bankruptcy Act. On the same day, by *ex parte* order, the District Court undertook to require the immediate surrender to a Trustee appointed by it, of approximately twenty millions of dollars of securities which had been deposited by Fidelity Assurance Association with officials of some fifteen states as required by the laws of such states. None of these securities were surrendered and subsequently on August 9, 1941, the turnover order was changed to an injunction (R. 319-334). In the meantime a number of states had intervened and filed answers controverting the Debtor's petition and others had filed motions to strike out the orders of June 6, 1941, and August 9, 1941. Controversial answers had also been filed by creditors and others.

After an extended hearing over a period of four months the District Court filed a lengthy opinion (R. 3-38) and on January 5, 1942, entered an order (R. 39-40) approving the Debtor's petition and overruling the numerous objections interposed by the Respondents. An appeal to the

Circuit Court of Appeals for the Fourth Circuit was filed on March 12, 1942, and that Court, holding that the Debtor was an insurance company and also that the petition had not been filed in good faith, reversed the District Court and remanded the cause with directions to the District Court to dismiss the petition (R. 363-388).

## THE FACTS.

It is unfortunate that the Petitioners have submitted to this Court a printed record which, although voluminous, is hardly adequate to present the facts essential to a proper consideration of their petition for certiorari. The record printed by the Petitioners contains much that could have been omitted and yet fails to include the Debtor's petition and the controversial answers; indeed, all the pleadings in the case, with two minor exceptions, are omitted.[1] Fortunately the actual facts (as distinguished from opinion facts or conclusions) necessary to a consideration of the petition for a writ of certiorari are largely undisputed and are fairly well set out in the opinion of the Circuit Court of Appeals.[2] For this reason and also because the essential facts not covered in the brief of the Petitioners are set out in briefs filed by other Respondents, we will

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[1] The Respondents suggested to the Petitioners that a stipulation as to the contents of the record be entered into as required by Rule 38(8) but the Petitioners chose instead to print the appendices to all the briefs filed in the Circuit Court of Appeals. These are disconnected and furnish a mere hodge podge of information for which the Petitioners have not even seen fit to prepare an index. The record certified to the Circuit Court of Appeals contained nearly 4,000 pages of testimony and 113 exhibits. Under the rules of the Circuit Court of Appeals the record was not printed and it was, of course, impossible to print any substantial portion thereof as appendices to briefs. However, a 47-page statement of facts was printed and the briefs were replete with references to and quotations from the complete record, none of which appear in the printed record here.

[2] Evidently the Petitioners also regard the Circuit Court of Appeals' statement of the facts as accurate (Petitioners' Brief, p. 63). Practically all references to the record in support of Petitioners' statement of facts are to the opinion of the Circuit Court of Appeals; in a few instances the opinion of the District Court is referred to. In only one instance have the Petitioners referred directly to the testimony given before the District Court.

not in this brief undertake to include a full statement of facts.

We do wish to point out, however, that the state court proceeding in Maryland is not a receivership proceeding. Under the Maryland statute securities were deposited with and assigned to the Insurance Commissioner in trust for Maryland contract holders.[3] There are no general assets of Fidelity in Maryland and the Insurance Commissioner as trustee is administering the trust created by the Maryland statute under the supervision of a court of equity. While there has been no effort to completely liquidate the securities held in trust in Maryland, there has been a partial liquidation resulting chiefly from redemptions. At the present time about 40% of the trust assets are in cash and the balance is represented by marketable securities, most of which are high grade and quoted at a price considerably in excess of par. These securities have depreciated in value since June, 1941.

As a matter of fact all of the assets deposited with the 14 states other than West Virginia, are readily marketable securities and the only doubtful assets of the Debtor (as to which the Petitioners contend "slow liquidation" is necessary) are concentrated in West Virginia and, if this proceeding were dismissed, they would be administered by only one court, the Circuit Court for Kanawha County, West Virginia.

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[3] The important sections of the Maryland statute are printed in full in the record at pages 203-209. Section 222 (R. 205-206) prohibits the transaction of business in Maryland "unless and until such company shall have assigned to and deposited with the Commissioner, or with some independent trust company approved by him, in trust, as security for all the holders of contracts or other obligations heretofore or hereafter sold, negotiated, issued or accrued in said company in the State of Maryland" approved securities having a market value "at no time less than the aggregate contract liability of the company under all contracts heretofore or hereafter sold in the State of Maryland."

## SUMMARY OF ARGUMENT.

The Circuit Court of Appeals for the Fourth Circuit decided two and only two questions, namely: (1) that the Debtor was an insurance company and, therefore, could not file a petition for reorganization under Chapter 10 of the Bankruptcy Act, and (2) that the Debtor's petition was not filed in good faith within the meaning of Section 146 of the Bankruptcy Act and, therefore, should have been dismissed because the interests of creditors would be best subserved in the prior pending state court proceedings, since it was virtually conceded below by all parties, and by the District Court, that reorganization as a going concern was not feasible and that liquidation in some form was inevitable. The Respondents, who were Appellants below, raised a number of other questions, a favorable decision on any one of which would have resulted in the reversal of the order of the District Court, but the Circuit Court of Appeals deemed it unnecessary to pass upon any of these questions in view of its decision on the above two questions.

The Petitioners advance as their reasons for the further review by this Court on certiorari of the two questions decided by the Circuit Court of Appeals, four of the five grounds for the granting of a writ of certiorari set forth in paragraph 5(a) of Rule 38 of this Court. It is the contention of the Respondents that none of these reasons are sound, and in this brief we will make the following points in support of our position.

POINT I. No important question of federal law which has not been but should be settled by this Court was decided by the Circuit Court of Appeals.

1. The decision of the Circuit Court of Appeals that the Debtor was an insurance company at the time

of the filing of the petition for reorganization is not in conflict with the Investment Company Act of 1940. (Petitioners' Point I).

2. The decision of the Circuit Court of Appeals that the Debtor at the time of the filing of the petition for reorganization was an insurance company within the meaning of Section 4 of the Bankruptcy Act does not present a question of federal law which has not been but should be settled by this Court. (Petitioners' Point II).

3. The decision of the Circuit Court of Appeals that the interest of creditors of the Debtor would be best subserved by the prior pending state court proceedings does not present a question of federal law which has not been but should be settled by this Court. (Petitioners' Point VII).

POINT II. There is no conflict between the decision of the Circuit Court of Appeals and the applicable decisions of this Court.

1. There are no decisions of this court as to what is an insurance company within the meaning of Section 4 of the Bankruptcy Act. (Petitioners' Point III).

2. The decisions of this court in *Bowers v. Lawyers Mortgage Company*, 285 U. S. 182; and *United States v. Home Title Insurance Company*, 285 U. S. 191, are not applicable in determining what is an insurance company within the meaning of Section 4 of the Bankruptcy Act. (Petitioners' Point III).

3. Even if such decisions of this court were applicable, the decision of the Circuit Court of Appeals would not be in conflict therewith. (Petitioners' Point III).

POINT III. The Circuit Court of Appeals did not decide an important question of local law in a way which was probably in conflict with applicable local decisions.

1. There are no applicable local decisions on the question of what is an insurance company under the law of West Virginia. (Petitioners' Point IV).

2. The Circuit Court of Appeals correctly and properly applied and interpreted the West Virginia statutes in holding that the Debtor was an insurance company under such statutes at the time of the filing of the petition for reorganization. (Petitioners' Point IV).

POINT IV. There is no conflict between the decision of the Circuit Court of Appeals for the Fourth Circuit and the decisions of other circuit courts of appeals.

1. There is no conflict in the decisions of the various circuit courts of appeals on the question of what is an insurance company within the meaning of Section 4 of the Bankruptcy Act as amended by the Act of 1910. (Petitioners' Point V).

2. The Circuit Court of Appeals held that the Debtor was an insurance company at the time of the filing of the petition for reorganization because: (a) it was classified as an insurance company by the laws of the State of West Virginia, (b) it was classified as an insurance company by the States generally, (c) it had the charter powers of an insurance company, and (d) its activities during the six months prior to the filing of the petition for reorganization were those of an insurance company. In no case where all these factors are combined has any Circuit Court of Appeals held that the company is not an insurance company. The decision of the Circuit Court of Appeals is, therefore, not in conflict with a decision in any other circuit. (Petitioners' Point V).

3. The Circuit Court of Appeals referred to the contention of the Petitioners that "slow and orderly liquidation" was a method of reorganization under Chapter 10 of the Bankruptcy Act but it did not decide the question and it did not hold that reorganization means only rehabilitation as a going concern. (Petitioners' Point VI).

## ARGUMENT.

### POINT I.

### NO IMPORTANT QUESTION OF FEDERAL LAW WHICH HAS NOT BEEN BUT SHOULD BE SETTLED BY THIS COURT WAS DECIDED BY THE CIRCUIT COURT OF APPEALS.

1.

*No Conflict With Investment Company Act Of 1940.*

The Petitioners argue that Congress has expressly recognized that face amount certificate companies are subject to the Bankruptcy Act because the Investment Company Act of 1940 amends certain sections of the Bankruptcy Act making special provisions with reference to procedure in the bankruptcy of face amount certificate companies. They further argue that the Debtor is a face amount certificate company and not an insurance company as those terms are defined in the Investment Company Act of 1940. On these two premises the Petitioners contend that the Circuit Court of Appeals erred in classifying the Debtor as an insurance company. This point was never suggested to the lower court and is raised for the first time here, but the complete fallacy of the argument as applied to the present case is apparent from the opening paragraph of the argument in Petitioners' brief (Brief p. 19), wherein the Petitioners state that they are only considering the corporate powers and the business activities of the debtor during the period from 1912 to December 31, 1940, without reference to either the corporate powers or the business activities of the Debtor on and after January 1, 1941.

The Respondents do not contend that investment companies or face amount certificate companies are excluded from the provisions of the Bankruptcy Act. Likewise, the Respondents do not contend and the Circuit Court of Appeals did not hold that prior to December 31, 1940, the Debtor was an insurance company and not an investment company or face amount certificate company. On the contrary, the Respondents contended below and the Circuit Court of Appeals held that by virtue of its charter powers and its corporate activities and its classification by the State of West Virginia, and by the States generally, the Debtor *on and after January 1, 1941*, was an insurance company and as such excluded from the Bankruptcy Act. Since the petition for reorganization was filed on June 6, 1941, the character of the debtor corporation as of that date is the controlling factor and it avails nothing to say that as of a date more than six months prior to the date of the filing of the petition the Debtor was not an insurance company, if in fact it was such at the time the petition was filed. No authority to the contrary has been or can be cited by the Petitioners.

Tested by either the so-called state classification theory or the so-called corporate activities theory, the Debtor undoubtedly was an insurance company within the meaning of Section 4 of the Bankruptcy Act on and after January 1, 1941.[4] On December 31, 1940, the Debtor amended its charter so as to become an insurance company,[5] and on and after that date it did everything possible to become an insurance company, as distinguished from a face amount certificate company, for the announced purpose of avoiding compliance with the Investment Company Act of 1940. This was not, as contended by the Petitioners, merely an

[4] This point is developed more fully in the Wisconsin-Iowa brief.

[5] The facts as to the change in the Debtor's charter and the issuance to it of an insurance company license are more fully discussed in the Wisconsin-Iowa brief.

abortive effort at "extra judicial reorganization". The Investment Company Act of 1940 effectually ended the Debtor's career as an investment company issuing face amount certificates, because it was utterly impossible for the Debtor to comply with the regulatory provisions of that Act and of the complementary West Virginia statute (R. 367; Petitioners' Brief, p. 7). The Debtor, therefore, did not register under the provisions of Section 8 of the Investment Company Act (U. S. Code, Title 15, Sec. 80a-8), and never became a registered face amount certificate company. As an unregistered investment company it could not, after January 1, 1941,[6] issue new face amount certificates, or purchase or sell securities, or even service and receive payments on contracts issued prior to January 1, 1941.[7]

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[6] Section 7(a) of the Investment Company Act (U. S. Code, Title 15, Sec. 80a-7(a)):

"No investment company organized or otherwise created under the laws of the United States or of a State and having a board of directors, unless registered under section 80a-8, shall directly or indirectly—

(1) offer for sale, sell, or deliver after sale, by the use of the mails or any means or instrumentality of interstate commerce any security or any interest in a security, whether the issuer of such security is such investment company or another person; or offer for sale, sell, or deliver after sale any such security or interest, having reason to believe that such security or interest will be made the subject of a public offering by use of the mails or any means or instrumentality of interstate commerce;

(2) purchase, redeem, retire, or otherwise acquire or attempt to acquire, by use of the mails or any means or instrumentality of interstate commerce, any security or any interest in a security, whether the issuer of such security is such investment company or another person;

(3) * * *

(4) engage in any business in interstate commerce;

(5) * * *"

[7] Practically all of Debtor's business was in interstate commerce. The sending of notices, receipt of payments, etc., was handled by mail between the home office in West Virginia and contract holders in other states. Purchases and sales of securities were also transactions in interstate commerce.

It should also be noted that the Debtor's contracts, whether made before or after January 1, 1941, to the extent they were performed after that date, would be void under Section 46(b) of the Act (U. S. Code, Title 15, Sec. 80a-46(b)). This would operate to prevent the Debtor from receiving payments on its contracts unless it could become a registered company.

It was, therefore, not merely an attempt at "extra judicial reorganization" which prompted the Debtor to convert into an insurance company; it was also the realization that the only alternative was liquidation and dissolution.[8] As an insurance company, but only as an insurance company, the Debtor could transact new business and continue to receive payments on its contracts issued prior to January 1, 1941, because insurance companies were exempted from compliance with the Investment Company Act of 1940 and also the complimentary West Virginia statute.[9] Section 3(a)(2) of the Investment Company Act[10] defines an investment company as one engaging in the business of issuing face amount certificates, or which has been engaged in such business and has such certificates outstanding, but Section 3(c)(3)[11] provides that notwithstanding such definition an insurance company is not to be deemed an investment company. Consequently, as an insurance company the Debtor could continue to receive payments on its outstanding contracts without violating

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[8] One other possible alternative would have been to apply to the Securities and Exchange Commission for exemption under Section 6(c) (U. S. Code, Title 15, Sec. 80a-6(c)), but this obviously would have been a forlorn hope.

[9] The West Virginia statute is printed in full in the appendix to Petitioners' Brief, pp. 56-59.

[10] U. S. Code, Title 15, Sec. 80a-3(a)(2):

"(a) When used in this subchapter and sections 72(a), last sentence, and 107(f) of Title 11, 'investment company' means any issuer which—

(1) * * *

(2) is engaged or proposes to engage in the business of issuing face-amount certificates of the installment type, or has been engaged in such business and has any such certificate outstanding; * * *."

[11] U. S. Code, Title 15, Sec. 80a-3(c)(3):

"(c) Notwithstanding subsections (a) and (b), none of the following persons is an investment company within the meaning of this subchapter and sections 72(a), last sentence, and 107(f) of Title 11:

(1) * * *

(2) * * *

(3) Any bank or insurance company; * * *."

the Investment Company Act. For this reason, among others, the Debtor became an insurance company on December 31, 1940.

As the Circuit Court of Appeals well stated: "Since the company deliberately assumed this new character to escape the requirements of the new federal and state statutes with respect to annuity companies, no weight should be given to the company's attempt to pose as an annuity company in the pending petition in bankruptcy". (R. 379)

Moreover, the Debtor was unquestionably an insurance company on and after January 1, 1941, even if we apply the definition of an insurance company as set out in Section 2(a)(17) of the Investment Company Act.[12] After that date it undoubtedly had an insurance company charter; it did write 9,802 insurance contracts; it issued no other new contracts whatsoever and its only other business activity was the servicing of contracts issued prior to January 1, 1941;[13] and it was under the supervision of the Insurance Commissioner of West Virginia.

It follows, therefore, that even if it could be said that the Investment Company Act of 1940 was applicable, the Debtor was an insurance company (and hence not an in-

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[12] U. S. Code, Title 15, Sec. 80a-2(a)(17):

"(a) When used in this subchapter and sections 72(a), last sentence, and 107(f) of Title 11, unless the context otherwise requires—

* * * * * * *

(17) 'Insurance company' means a company which is organized as an insurance company, whose primary and predominant business activity is the writing of insurance or the reinsuring of risks underwritten by insurance companies, and which is subject to supervision by the insurance commissioner or a similar official or agency of a State; or any receiver or similar official or any liquidating agent for such a company, in his capacity as such.

* * * * * *"

[13] As pointed out in the opinion of the Circuit Court of Appeals (R. 379), and as discussed more fully in the Wisconsin-Iowa brief, the servicing of these contracts constituted the transaction of an insurance business.

vestment company or face amount certificate company) as that term is defined in the Act, at the time of the filing of the petition in bankruptcy.

2.

***Decision That Debtor Is An Insurance Company Does Not Present A Question Which Need Be Reviewed By This Court.***

The question of whether or not the Debtor is an insurance company within the meaning of Section 4 of the Bankruptcy Act is discussed more in detail in the Wisconsin-Iowa brief. In this brief, however, we wish to point out that the question is not a question of federal law which has not been, but should be, settled by this Court, and the decision of the Circuit Court of Appeals on this point, therefore, does not present any ground for the review thereof by this Court.

The question is not one which, as contended by the Petitioners, is likely to recur frequently. As a matter of fact there are now and have been for a great many years only two other corporations in the United States engaged in the type of business conducted by the Debtor prior to December 31, 1940, but even that is beside the point here because the Debtor procured an insurance company charter on December 31, 1940, and radically changed its business activities on and after January 1, 1941. Neither of the other two face amount certificate companies have been so converted into insurance companies.

In addition, the Circuit Court of Appeals, while in general approving the so-called state classification rule as the controlling principle in determining the character of a corporation under Section 4 of the Bankruptcy Act, nevertheless did not rest its decision solely on that theory but instead held that under the facts of this case, the Debtor was an insurance company because *on and after January 1,*

1941, (1) it was classified as such by the State of West Virginia, (2) it was classified as such by most of the States of the United States, (3) its charter had been specifically amended so as to make it an insurance company, and (4) its business activities were those of an insurance company. It follows, therefore, that no matter whether the one rule or the other be a proper criterion, the decision of the Circuit Court of Appeals was, nevertheless, correct and would necessarily be affirmed by this Court even though this Court should hold the so-called state classification theory to be improper.

We should also like to point out that in the case, *In Re Union Guarantee and Mortgage Co.*, 75 Fed. (2) 984, precisely the same point as that here raised by the Petitioners was raised in a petition for certiorari filed on behalf of the Union Guarantee and Mortgage Co., but this Court denied certiorari in 296 U. S. 594. The arguments made by the Petitioners here are practically identical with the arguments made by the petitioner in the *Union Guarantee and Mortgage Co.* case, as will be seen from an examination of the petition and supporting brief filed in the latter case. There the lower court had held that the Union Guarantee and Mortgage Co. was an insurance company and the petition for certiorari made the point that this was a decision of an important question of federal law which had not been but should be settled by this Court, and further that the decision of the lower court in that case was in conflict with the decisions of this Court and in conflict with the decisions of other circuit courts of appeals. The same authorities relied upon by the petitioner in that case are relied upon by the Petitioners here, and yet this Court denied certiorari.

The same thing was true in the case of *In Re Prudence Co.*, 79 Fed. (2d) 77, cert. den., 296 U. S. 646, where the

lower court held that The Prudence Company was not an insurance company or a banking corporation. As a matter of fact, this Court has never granted a writ of certiorari to review a decision of the Circuit Court of Appeals holding that a corporation either was or was not an ir urance company, a banking corporation, or a building and loan association within the meaning of Section 4 of the Bankruptcy Act. So far as we are aware, this Court has denied certiorari in every instance in which such questions have been presented. *Gamble vs. Daniel*, 39 Fed. (2d) 447, cert. den. 282 U. S. 848; *Security Building & Loan Ass'n. vs. Spurlock*, 65 Fed. (2d) 768, cert. den. 290 U. S. 678; *In Re Peoria Life Insurance Co.*, 75 Fed. (2d) 777, cert. den. 296 U. S. 594.

3.

***Prior Pending State Court Proceedings.***

The Petitioners apparently recognize that the decision of the Circuit Court of Appeals to the effect that the interests of creditors would be best subserved in the prior pending state court proceedings is a decision of a question of fact rather than one of law, because they suggest that the federal question presented is an inquiry as to what are the considerations for determining when the prior state court proceedings best subserve the interests of creditors. We must say that we have considerable difficulty in following this reasoning.

Obviously whether or not prior pending state court proceedings best subserve the interests of creditors is a question of fact which must be determined upon a consideration of all the facts and circumstances in the particular case. It is not possible nor practicable nor desirable to attempt to limit or define just what facts should and what facts should not be considered in resolving this question,

any more than it is practicable or desirable to define fraud. All that can be said is that the court must consider *all* of the facts and circumstances disclosed by the record. Considerable judicial discretion is involved in the ultimate decision, but it, nevertheless, is a decision on a question of fact and not a decision on a question of law. What would best subserve the interests of creditors in one case may not best subserve their interests in another case.

In any event the question is not one of the kind which should be reviewed by this Court, and this Court has consistently refused to grant certiorari to review decisions of Circuit Courts of Appeals involving the issue of good faith in 77B or Chapter 10 proceedings. *In Re Bush Terminal Co.*, 84 Fed. (2d) 984, cert. den. 299 U. S. 596; *In Re 333 N. Michigan Avenue Building Corp.*, 84 Fed. (2d) 936, cert. den. 299 U. S. 602; *Texas Hotel Securities Corp. vs. Waco Development Co.*, 87 Fed. (2d) 395, cert. den. 300 U. S. 679; *First National Bank vs. Conway Road Estates Co.*, 94 Fed. (2d) 736, cert. den. 304 U. S. 578; *Price vs. Spokane Silver & Lead Co.*, 97 Fed. (2d) 237, cert. den. 305 U. S. 626; *In Re Mt. Forest Fur Farms of America*, 103 Fed. (2d) 69, cert. den. 308 U. S. 583.

In their brief (p. 45) the Petitioners suggest that the question here presented is also presented by the case of *In Re Marine Harbor Properties*, 125 Fed. (2d) 296, cert. granted, 86 L. Ed. (adv.) 729 (No. 24, October Term, 1942), and the case of *In Re Paloma Estates*, 126 Fed. (2d) 72, petition for certiorari filed May 12, 1942, and not yet acted upon. At the same time, the Petitioners further suggest that the disposition of these two cases will not necessarily determine the principles governing the disposition of the case at bar. We have carefully examined the petitions for certiorari and the briefs in each of these two cases and we respectfully submit that the questions presented in each

of them are entirely different from that presented by the Petitioners in the case at bar. In the *Marine Harbor Properties* case, the Circuit Court of Appeals for the Second Circuit dismissed the petition for reorganization on the ground that it was not filed in good faith because the Debtor had, some six years before, participated in a state court reorganization proceeding. As stated by the petitioner in his brief, "the question of good faith was resolved by the Circuit Court in terms of an alleged personal disqualification of the particular Debtor." An examination of the specification of errors urged by the petitioner there also discloses that the chief complaint was that the Circuit Court of Appeals for the Second Circuit had refused to determine whether or not the interests of creditors would be best subserved in the state court proceeding because of its holding that the debtor by reason of its participation in such proceeding was estopped from filing a petition for reorganization under Chapter 10. In the *Paloma Estates* case, the petitioner raised precisely the same question and contended that the decision of the Second Circuit Court of Appeals was again put upon the basis of a personal disqualification of the debtor by reason of its participation in a prior state court proceeding. However, the Respondents point out in their brief in opposition that the Second Circuit Court of Appeals did not base its decision upon this point alone, but proceeded to determine whether in fact the interests of creditors would be best subserved in the state court proceedings. They also point out that the dissenting judge in the Circuit Court of Appeals objected to the majority decision solely on the ground that the proof relied upon to show that the interests of creditors would be best subserved in the state court proceeding was in affidavit form and for that reason insufficient. The dissenting judge voted to remand the case so that further evidence could be adduced on the question of fact as to whether the

interests of creditors would be best subserved in the state court proceedings.

In the case at bar, the Circuit Court of Appeals has considered the voluminous evidence on this point and has reached the conclusion that the interests of the creditors would be best subserved in the prior pending state court proceeding. This decision on a question of fact is, therefore, quite different from the questions presented in the *Marine Harbor Properties* and *Paloma Estates* cases.

## Point II.

### THERE IS NO CONFLICT BETWEEN THE DECISION OF THE CIRCUIT COURT OF APPEALS AND THE APPLICABLE DECISIONS OF THIS COURT.

The Petitioners admit that there are no decisions of this Court on the question of what is an insurance company within the meaning of Section 4 of the Bankruptcy Act. They contend, however, that the decisions of this Court in *Bowers vs. Lawyers Mortgage Company*, 285 U. S. 182, and *United States vs. Home Title Insurance Company*, 285 U. S. 191, although dealing with the question of what is an insurance company within the meaning of Federal tax statutes, are nevertheless applicable in determining what is an insurance company under Section 4 of the Bankruptcy Act, and that the decision of the Circuit Court of Appeals on this question is in conflict with the decisions of this Court in those two cases. The Respondents here contend that the decisions in the *Bowers* and *Home Title Insurance Company* cases are not applicable in the present case but that even if they were, the decision of the Circuit Court of Appeals is not inconsistent therewith.

The *Bowers* and *Home Title Insurance Company* cases involved solely the question of whether the companies there involved were insurance companies within the mean-

ing of the Federal Capital Stock Tax Law and the Federal Income Tax Law. This Court said that a general definition of an insurance company was not necessary in order to determine whether *"having regard to the purpose of the classification and the considerations on which it probably was made"* the taxing statutes had classified the two companies there involved as insurance companies. Upon an examination of the considerations on which the classification had been made in the taxing statutes this Court held that the company in the first case was not an insurance company within the meaning of the taxing statutes but that the company in the second case was. Obviously those decisions have no bearing at all on the question of what is an insurance company within the meaning of Section 4 of the Bankruptcy Act. The considerations which prompted Congress to classify and exempt certain specified corporations in Section 4 of the Bankruptcy Act were entirely different from the considerations which prompted Congress in providing specially for the taxation of certain types of corporations. The Circuit Court of Appeals examined the purpose of the classification in the Bankruptcy Act and the considerations on which it probably was made, and concluded that the Debtor was an insurance company within the meaning of that Act.

Even if it were assumed that the decisions in the *Bowers* and *Home Title Insurance Company* cases were applicable in the present case, nevertheless the decision of the Circuit Court of Appeals in the present case is not inconsistent therewith. In the *Bowers* and the *Home Title Insurance Company* cases this Court held that, having regard to the purpose of the classification in the tax statute and the considerations upon which it was made, it was necessary to examine the corporate activities of the company in order to determine its character. This Court further held that

although the question of whether the company was formed under the state insurance laws was significant, it was not controlling. But if we apply these same tests to the Debtor, the conclusion is, nevertheless, that it was an insurance company at the time of the filing of the petition for reorganization because it not only was classified as an insurance company by the State of West Virginia and chartered and licensed under the insurance laws of that State, but its activities during the six months preceding the petition for reorganization were those of an insurance company. Consequently there is no inconsistency between the decision of the Circuit Court of Appeals and the above referred to decisions of this Court.

## Point III.

### THE CIRCUIT COURT OF APPEALS DID NOT DECIDE AN IMPORTANT QUESTION OF LOCAL LAW IN A WAY WHICH WAS PROBABLY IN CONFLICT WITH APPLICABLE LOCAL DECISIONS.

As the Petitioners themselves admit, there are no applicable decisions of the courts of West Virginia as to whether the Debtor, or other companies like it, are to be considered as insurance companies. However, the contention is made that the statutes of West Virginia classified the Debtor as an investment company and not as an insurance company, and that the Circuit Court of Appeals erroneously applied these statutes. The fallacy of the contention is obvious because the Petitioners consider only the charter powers and activities of the Debtor prior to December 31, 1940, whereas the Circuit Court of Appeals in determining the classification of the Debtor as an insurance company under the laws of the State of West Virginia considered its charter powers and activities subsequent to January 1, 1941. Here again the Petitioners choose to ignore the change in the character of the Debtor's charter powers and

activities which occurred on and after January 1, 1941. But the character of the Debtor at the time of the filing of the petition for reorganization is controlling, and it is not possible to ignore the last six months of its existence and consider only its charter powers and corporate activities prior to that time.

The lower court has thus not misapplied the applicable statutes of West Virginia.

## POINT IV.

## THERE IS NO CONFLICT BETWEEN THE DECISION OF THE CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT AND THE DECISIONS OF OTHER CIRCUIT COURTS OF APPEALS.

### 1.

### *The Decision That The Debtor Is An Insurance Company Is Not In Conflict With Decisions In Other Circuits.*

A superficial examination of the authorities might seem to indicate a conflict among the various circuit courts of appeals as to the principles to be applied in determining whether or not a particular corporation is one of those excepted from the provisions of the Bankruptcy Act under Section 4 thereof, but we believe a more careful analysis of the decisions will show that actually this is not the case.[14]

We wish to point out, however, that regardless of whether there might appear to be a conflict among the various circuit courts of appeals as to the application of the so-called state classification theory, the so-called charter power theory, or the so-called business activities theory, nevertheless this is not a case in which this Court can resolve any such supposed conflicts. Although the Circuit Court of Appeals in this case in general approved the so-called state classification theory, it, nevertheless, held that

[14] This point is discussed more in detail in the Wisconsin-Iowa brief.

no matter which theory is applied, the Debtor must be regarded as an insurance company since, (1) it was an insurance company under the laws of the State of West Virginia and under the laws of the States generally, (2) it had the charter powers of an insurance company, and (3) its activities during the six months prior to the filing of the petition for reorganization were those of an insurance company. As pointed out by the Circuit Court of Appeals in its opinion (R. 372), the Debtor would be classified as an insurance company even if the rule of classification approved by the District Court were followed because, although neither of the Petitioners herein had seen fit to bring the matter to the attention of the District Court, it later developed and is now admitted that the Debtor actually issued 9802 insurance contracts subsequent to January 1, 1941. (R. 339-352, 361-362).

2.

***The Circuit Court Of Appeals Did Not Pass On The Question Of Whether Or Not "Slow And Orderly Liquidation" Is A Method Of Reorganization.***

The Circuit Court of Appeals decided it was not reasonable to expect that a plan of reorganization of the Debtor as a going concern could be effected, and the Petitioners argue that in so deciding the Circuit Court of Appeals held that "slow and orderly liquidation" in the Federal Court was not reorganization within the meaning of Chapter 10 of the Bankruptcy Act. They then undertake to point out that such decision of the Circuit Court of Appeals is in conflict with the decisions of other circuit courts of appeals in several other cases cited. We do not concede that the cases cited are applicable, but without arguing the question of whether reorganization includes "slow and orderly liquidation" we think it sufficient merely

to point out that the question was not decided by the Circuit Court of Appeals and, therefore, is not presented to this Court on the record.

The Circuit Court of Appeals held, largely on the basis of findings of fact of the District Court, that it was clearly not feasible to rehabilitate the Debtor as a going concern. The Court referred to the fact that this was virtually conceded by the District Court and by the Debtor, the Trustee, and the Securities and Exchange Commission, and it pointed out that the only suggestion made by these parties was that it was feasible to have a "slow and orderly liquidation" in the Federal Court, and that such a "slow and orderly liquidation" was a method of reorganization within the meaning of Chapter 10 of the Bankruptcy Act. The Circuit Court of Appeals clearly did not pass on the question of whether a "slow and orderly liquidation" was a method of reorganization, but, instead, held (1) that the record did not justify the conclusion that it was reasonable, or feasible, or desirable to have a "slow and orderly liquidation" in the Federal Court, and (2) that since liquidation was inevitable, the question then arose as to whether the interests of the creditors would be best subserved by such a liquidation in the Federal Court, or by liquidation in the state courts (R. 381-384). After reviewing all of the circumstances, the Circuit Court of Appeals decided in favor of the latter (R. 384-387).

There is, therefore, no conflict between the decision of the Circuit Court of Appeals and the decisions of other circuit courts of appeals cited by the Petitioners which they contend hold that "slow and orderly liquidation" is a method of reorganization, because there has been no decision on this question by the Circuit Court of Appeals.

## CONCLUSION.

We respectfully submit, therefore, that the petition for a writ of certiorari should be denied.

Respectfully submitted,

H. VERNON ENEY,

GUY B. BROWN,

Counsel for Respondent, John B. Gontrum, Insurance Commissioner of Maryland.

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No. 319

In the

# Supreme Court of the United States

FIDELITY ASSURANCE ASSOCIATION AND CENTRAL TRUST COMPANY, TRUSTEE OF FIDELITY ASSURANCE ASSOCIATION,
*Petitioners,*

*vs.*

EDGAR B. SIMS, AUDITOR OF THE STATE OF WEST VIRGINIA, ETC., ET AL.,
*Respondents.*

## JOINT REPLY TO PETITION FOR WRIT OF CERTIORARI ON BEHALF OF L. H. BROOKS, TRUSTEE, FREDERIC LEAKE AND A. L. GOLDBERG, JR., TRUSTEE, AND DEWEY S. GODFREY, RECEIVER FOR FIDELITY ASSURANCE ASSOCIATION IN THE STATE OF MISSOURI.

WELDON B. WHITE,
FYKE FARMER,
Counsel for L. H. Brooks, Trustee, Frederic Leake and A. L. Goldberg, Jr., Trustee.
RUDOLPH K. SCHURR,
Counsel for Dewey S. Godfrey, Receiver in the State of Missouri.

BAIRD-WARD—NASHVILLE

## FOREWORD.

"We think it is our duty to review the situation realistically, and when this is done, there appears to be no reasonable hope of the reorganization of the business as a going concern, but only the immediate need of a liquidation of the company's assets for the benefit of the contract holders."

Opinion of Court of Appeals.

"It is true that the broad picture developed by the testimony at the hearing does not present a very favorable view with respect to the rehabilitation and continued operation of the Debtor as a face-amount certificate company."

Opinion of District Judge.

In the

# Supreme Court of the United States

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**FIDELITY ASSURANCE ASSOCIATION AND CENTRAL TRUST COMPANY, TRUSTEE OF FIDELITY ASSURANCE ASSOCIATION,**

***Petitioners,***

***vs.***

**EDGAR B. SIMS, AUDITOR OF THE STATE OF WEST VIRGINIA, ETC., ET AL.,**

***Respondents.***

---

**PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT.**
**JOINT REPLY OF L. H. BROOKS, TRUSTEE, FREDERIC LEAKE AND A. L. GOLDBERG, JR., TRUSTEE, AND DEWEY S. GODFREY, RECEIVER IN THE STATE OF MISSOURI, RESPONDENTS.**

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*MAY IT PLEASE THE COURT:*

**The Issue—*Central Trust Company v. Contract Holders.***

In order that we may avoid the awkward and aweless position of straining at a gnat and swallowing a camel, let us recur at the outset to the question, What is the object of this suit? Anyone reading the petition presented in this case might easily lose sight of the fact that the primary and basic issue is whether or not this insolvent company *should* be reorganized.

It is not of the greatest importance whether everyone can assent to the process of reasoning by which the Court of

Appeals reached its conclusion that the corporation was an insurance corporation and hence excluded from the Bankruptcy Act. The effect of the decision was that there should be an immediate liquidation for the benefit of the contract holders instead of a deferred and slow liquidation for the benefit of the Central Trust Company.

The gist of the opinion of the Court of Appeals is expressed in the following sentence:

> "It has not been and cannot be reasonably contended that the interests of the well secured creditors will be advanced by interfering with the state officials in the prompt liquidation and distribution of the securities in their hands. The liquidation in every state in which deposits were made will be subject to the supervision of established governmental departments, as well qualified for the business as the trustee in bankruptcy. There is every reason to believe that the liquidation under their supervision will proceed without needless expense in a careful and expeditious manner so as to save as much as possible for the contract holders. *Certainly it would be unjust and unreasonable to delay the satisfaction of their claims in order that illusory hopes of reorganization may be entertained.*" (Italics ours)

We submit that no other decision would have met the demands of justice for the eighty thousand contract holders whose rights have been placed in jeopardy by this proceeding. Had the case not been wholly excluded from the Bankruptcy Courts, these contract holders whould have been left defenseless against harassment and delay from further efforts to deprive them of the right to the imme-

diate distribution of the State deposits securing their claims.

**Pressing Need for Liquidation in Tennessee.**

The statutes of the State of Tennessee require investment companies, such as the Debtor, as a condition to the right to engage in business in that State, to deposit and maintain securities at no time less than 100 per cent of the issuing company's cash or current contract liability on all outstanding investment contracts sold in the State of Tennessee. By Chapter 209 of the Public Acts of 1939, it was provided that the Commissioner of Insurance and Banking of the State of Tennessee should hold as Custodian the securities deposited for the benefit of the holders of the investment contracts coming within the provisions of said Act. By Chapter No. 157 of the Public Acts of 1941, the State Treasurer of Tennessee was made the Custodian of all securities deposited with the State or any Department thereof. The laws of Tennessee further provide that only upon discharge in full of all liabilities on all investment contracts sold in the State of Tennessee, and for which trust deposit is maintained, shall the issuing company be entitled to a release and return of the securities so deposited.

In compliance with the laws of the State of Tennessee, and in order to obtain a permit to do business and issue its investment contracts in the State of Tennessee, the Debtor company made a deposit of securities with the Commissioner of Insurance and Banking of the State of Tennessee. Citizens of the State of Tennessee, in reliance upon the protection afforded by the laws of that State, purchased the investment contracts issued by Debtor.

The transcript of the proceedings in the Chancery Court of Davidson County, Tennessee, filed as an exhibit to the answer of the defendants to the Debtor's petition for reorganization shows that prior to the time the petition was filed, a suit was pending in the State Court to subject the deposit in Tennessee to the satisfaction of the claims of contract holders entitled to the benefit of deposit in that State. The deposited securities were then being held by the State Treasurer in pursuance to the statutes of that State, making him the Custodian of the deposit. By decree of the Chancery Court he had been enjoined from disposing of the deposit in any way except under orders of that Court. The time had been fixed for the filing of the claims of creditors and many claims had already been filed. Since that time many other claims have been filed. The time expired on November 1st, 1941.

But for the injunction or stay in the order of August 9, 1941, the Tennessee State Court could have proceeded with the distribution of the deposit in Tennessee after November 1, 1941. *The Debtor has no equity in the Tennessee deposit.* (Tr.; p. 225)

By reason of these facts, the deposit in Tennessee cannot be affected in any way by any attempt to reorganize the Debtor except by delaying distribution. Even if there is an attempt to effect a plan of reorganization, any plan of reorganization must give the Tennessee contract holders the option of obtaining satisfaction of their entire claims out of the deposit in Tennessee. This deposit under the laws of the State cannot be withdrawn until the discharge in full of all claims of Tennessee contract holders. Since in Tennessee the Insurance Commissioner is prevented by statute from giving an investment company a license to do busi-

ness unless it maintains a deposit of 100% of the amount of its cash liabilities to the holders of investment contracts sold in the State, there can be no scaling down *in invitum* of the claims of contract holders against the deposit so as to free any of the deposited securities for use in equalizing deficiencies in other States or to furnish working capital.

Respondents duly moved to vacate and set aside the stay order made by the District Court so as to permit the Chancery proceedings in the State Court to be prosecuted. Their motion was overruled by the District Judge. The Court of Appeals correctly envisaged the situation with respect to the State deposits generally, and concluded that it would be unjust and unreasonable to these contract holders to delay the satisfaction of their claims in order that illusory hopes of reorganization may be entertained.

**Pressing Need for Liquidation in Missouri.**

It is to the Missouri deposit that the Missouri contract holders must look for payment. The Commissioner of Securities in Missouri required the Debtor corporation, as a condition to the right to do business in that State, to deposit in trust for the benefit of Missouri contract holders securities equal to the amount of outstanding liabilities in that State. Prior to the appointment of the State Court receivers and prior to the filing of the petition for reorganization, the Attorney-General for the State of Missouri on the information of the Commissioner of Securities instituted a proceeding in the Missouri State Court and obtained the appointment of a receiver.

When the Missouri contract holders purchased their contracts, they were led to believe (as shown by Exhibits 37,

38, 39, 40, 85, 86 and 87) that they need look no further than the Missouri deposit for their protection, in payment of their contracts. The question with them is, when are they going to get their money? None of them would have turned his money over to Fidelity if he had contemplated the slightest possibility of the deposit in his State becoming involved in protracted and expensive litigation in a Federal Court nearly one thousand miles distant.

The Missouri contract holders are not concerned with the deposits in the State of Maryland or in Tennessee or in West Virginia, or in any other State which required deposits for the protection of contract holders in that State. They have no purpose to deprive any other State of any of the benefits of deposits made therein in accordance with applicable laws and regulations of the several Insurance and Securities Commissioners. The claim of the average contract holder is of a small amount. They can see nothing but injustice to the contract holders in any scheme or plan that has for its purpose the handling of all claims of all contract holders in the State of West Virginia, regardless of the State in which the contract holders reside.

There have been protestations of good faith by the various counsel who have appeared for the company in this proceeding, as well as the attorneys for the Central Trust Company, and assurances from them that they have no purpose but to do "equity" to *all* contract holders. Despite this, the Missouri contract holders know that the maintenance of this proceeding forebodes no good for them. They know that this proceeding would not be maintained for the purpose of upholding and enforcing their rights in the deposit which secures their claims. That object would be best accomplished in their own State. The proceeding has a

meaning only if the object is to destroy or alter their rights in their deposit, either by cutting down their claims or postponing the time of payment. This does not seem to be "equity" to them.

**State Deposits Do Not Constitute "Assets" Which May Be Made Basis of Reorganization.**

The very pertinent fact that Fidelity has nothing of its own to reorganize with is obscured by petitioners' statement that its aggregate assets amount to $21,100,000.00 or approximately ninety per cent of its aggregate liabilities, $23,476,000.00. The Court of Appeals showed the situation by a tabulation of the State deposits as compared with liabilities. (Tr., p. 366) At the time of the filing of the petition, as the Court of Appeals points out, Fidelity's undeposited assets amounted to only a little more than a million dollars. And there was a deficiency of nearly three million five hundred thousand dollars between the deposits and the liabilities secured by the several deposits.

In this case *all* of the creditors are contract holders holding *secured claims*. Approximately $10,000,000.00 of securities, at the time of the filing of the petition, were held in deposits in States other than West Virginia. These fourteen other States are shown on Exhibit 48 printed in transcript at page 225. A little more than $10,000,000.00 of securities were deposited in West Virginia. This deposit was not made, however, for the sole benefit of contract holders in the State of West Virginia, but under the laws of that State supplied the deficiency between the deposits in all of the other States in which the company did business and the liabilities secured.

In the heading at the top of the page of each contract, the Company agreed to deposit approved securities in trust as required by the laws of the State of West Virginia. The laws of the State of West Virginia required a deposit *in trust* of bonds and securities approved by the Insurance Commissioner "to an amount equal to the total amount which such person, association or corporation may be liable to pay in cash to the holders of contracts under the terms thereof at the time of the deposit." It was further provided by the West Virginia statute that wherever other States required the corporation to make deposits to secure contract holders, the amount of the deposits in such other States might be deducted from the total amount required to be deposited with the Treasurer of the State of West Virginia.

These provisions, which were a part of the West Virginia laws, were, of course, by the provisions of the contract incorporated as a part of the contractual obligations of the Investment Company. Thus, when the Company deposited securities in Tennessee in accordance with the laws of the State of West Virginia, credit therefor was given against the West Virginia deposit. This was in compliance with the provisions of the contract that a reserve fund would be invested in approved securities and *deposited in trust*.

The Tennessee statutes in this regard are unambiguous. The amount of the deposit was to be not less than one hundred per cent of the cash or current contract liability on all outstanding investment contracts sold in the State of Tennessee. We mention Tennessee because we think its law is fairly typical of the laws of the thirteen other States (other than West Virginia) which required deposits.

While there is some slight difference between the wording of the section relating to the reserve fund contained in the different contracts, in substance the provision is the same. By this section (Section 1, Reserve Fund), the Company agreed to create and maintain a reserve fund. It was to be a special fund for the discharge of its liability under the different Series contracts. The reserve fund was to be set aside from payments received under the different Series contracts. This reserve fund by the terms of the contracts was to be invested in approved securities *and deposited in trust, as required by the laws of the State of West Virginia.* Plainly when the securities were *deposited in trust*, as required by the laws of the State of West Virginia, a valid trust came into existence.

Manifestly, no sort of a plan of reorganization could be effected which does not deal with the deposited securities. These represent by far the greater part of the company's assets. The non-deposited securities and assets would be consumed in paying taxes, expenses of administration, fees, etc. Debtor's petition shows that the prospect of reorganization depends entirely upon some modification of the rights of *all* contract holders in these deposited securities. It presupposes some kind of omnipotence in the Federal Court capable of effecting a recapture of these deposits for use in supplying the deficiency of more than three and a half million dollars between the assets and liabilities of the company so that it can continue in business.

In other words, Debtor's petition necessarily contemplates the carving of working capital out of the assets held in trust for contract holders. The petition is not copied in the printed transcript. For the convenience of the Court,

we have printed the pertinent Sections VII and VIII as Appendix B to this brief.

There could be no sort of reorganization that does not eliminate the deficiency between assets and liabilities. If the company is to continue in business as a face-amount certificate company, as an insurance company, or as any other kind of company, it would have to be launched in a condition of solvency. The only other alternative, it occurs to us, would be the sale or transfer of a part of the Debtor's business to some other company that is already functioning; and again insolvency is a barrier to such a plan. No businessman would take over assets with liabilities in excess of what he is getting.

Now when a business is insolvent—that is, when its liabilities are in excess of its assets—solvency can be attained in one of two ways only. Either the assets must be increased or the liabilities must be decreased. The assets of this company can be brought up to equal its liabilities only by new money being put in from the outside. All will agree that this is out of the question. The efforts of the company's directors and officers extending over a period of several years prior to the filing of the petition to bring in new capital demonstrate that this possibility has already been exhausted. (See Letter from John Marshall, Printed transcript, pp. 303-309.)

This leaves the possibility of scaling down the liabilities. It would not be enough to make them merely equal the assets. The liabilities would have to be reduced to an amount much less than the assets so as to free money from the trusts in which the securities are held to make capital and for use in paying operating expenses. It is our belief

that nothing like this has ever been attempted in the annals of corporate reorganizations.

Any plan which compels secured creditors to surrender without adequate consideration for the benefit of other creditors, whether secured or unsecured, the superior rights which they have acquired is inequitable and unfair.

The contract holders in those States having fairly adequate deposits cannot be required to surrender any of the rights and protection afforded to them by statutes in those States for the benefit of their less fortunate brethren in the other States where a disparity between deposits and liabilities is found. This Court has no power to legislate. It has no power to readjust deposits, for to do so would be to impair liens created by State laws. This is prohibited by Section 67(b) of the Bankruptcy Act, which by virtue of Section 102 is applicable to proceedings under Chapter X.

Great stress is placed by the petition upon the fact that there is some inequality as between the States having deposits and other States which either do not have any deposits or smaller deposits. If we grant the disparity which exists, the Federal Courts nevertheless have no power to change the situation which exists.

The Securities and Exchange Commission had been studying investment trusts and investment companies five years before the Investment Company Act undertaking to regulate face-amount certificate companies was recommended to Congress for enactment. The study was commenced in pursuance to the mandate contained in Section 30 of the Public Utility Holding Company Act of 1935 (15 U.S.C.A., Sec. 79z-4).

The Investment Company Act of 1940 (Title 15 U.S. C.A., Sec. 80a) expressly recites that it was upon the basis of facts disclosed by the record and reports of Securities and Exchange Commission and facts otherwise disclosed and ascertained, that it was found that investment companies were affected with a national public interest. The Securities and Exchange Commission made a special report on companies issuing face-amount installment certificates which was a part of its over-all report on its study of investment trusts and investment companies. Chapter V of this Special Report deals with the subject of Governmental Regulation of face-amount certificate companies.* On Page 128 is set out a summary of the deposit requirements of the various State statutes. The table 34 on page 130 sets out the amount of deposits and cash surrender liability of certificates outstanding of Fidelity Investment Association by States as of December 31, 1937.

In 1938, the Securities and Exchange Commission had obtained an injunction in the United States District Court for the Eastern District of Michigan against Fidelity Investment Association, enjoining it, among other things, from: "A. 1. Purchasing and depositing with West Virginia, or any other State, insufficient securities or securities which do not meet deposit requirements." (Special Report, p. 257).

The variation in State deposit laws was made the subject of a special study by the Senate and House Committees, to

*It is significant that it was reported that these companies "are essentially moneyed corporations, the regulation of which would seem to present problems in many respects comparable to the regulation of other types of money corporations *such as insurance companies and banks.*" (p. 123)

which the Investment Company Act was referred. Commissioner Healy was the first to point it out. (See hearings before Sub-Committee of the Committee on Interstate and Foreign Commerce on H R. 10065, Page 62.)

Mr. Schenker, counsel for the Securities and Exchange Commission made the following statement:

"... this bill in no way, Senator Herring, touches deposits that have been made to secure certificates issued up to the time of the passage of this bill". (Printed transcript p. 234.)

The report of Senator Wagner, Chairman of the Committee on Banking and Currency, accompanying the bill, states:

> *"The bill preserves the rights of residents in those States which require specific deposits with their State officials but makes provision for equalization of treatment of all certificate holders,* by providing that residents of other States must receive an amount equal to that received by the residents of States with deposits, before the latter can share in the general assets of the bankrupt company. (Sec. 29.)" (Italics ours)

We ask the Court to give special attention to the memorandum as to the hearings preceding the enactment of the Bill set out in the printed transcript at pages 226 to 237.

The Act contained an express reservation of the jurisdiction of State authorities. Section 50 provides as follows:

> "... nor shall anything in this title affect the jurisdiction of any other commission, board, agency, or officer of the United States or of any State or political

subdivision of any State, over any person, security, or transaction, insofar as such jurisdiction does not conflict with any provision of this title or of any rule, regulation, or order hereunder."

The proof is irrefragable that Congress thoroughly considered the question of the application of the bankruptcy power to the then existing deposits and deliberately decided to confer *no power* upon the Bankruptcy Court over deposits as they existed when the Act took effect.

**Validity of State Deposits Unquestioned.**

To this date (one year and nine months after the effective date of the Investment Company Act and Debtor's discontinuance of the issuance of new certificates), there has been no pleading filed in this case nor in any of the fourteen States in which Fidelity had deposits, nor anywhere else, in any way questioning the validity of the State deposits. The Court of Appeals assumed without argument that all of them must be given effect to. During the hearing the District Judge set aside the order made at the time of the presentation of the petition for reorganization which directed all of the deposits to be surrendered to the Trustee. His opinion takes note of the possibility of questions as to the deposits being raised but proceeds upon the assumption that recognition must be given to the State deposits.

We venture the assertion that rarely is a case presented to this Court in which testimony on the hearing on the issue of good faith was permitted to take so wide a range. Every phase of the company's activities was probed by those who endeavored to sustain the petition. We do not believe that there is any other evidence available to the

proponents of reorganization which will afford them any support in an effort to assail the State deposits.

How can it successfully be contended that all of the precautions which the States took for the protection of the investors in this Company against the day when there might be some failure on the part of the company to meet its obligations, *now that that day has arrived, must be held for naught?* Surely no court of equity would countenance for a minute such an attempt to undo the valid and salutary safeguards thrown up by the States to protect their citizens against the disaster which has come, except on grounds of a clear violation of some express prohibition in the Federal Constitution against State legislation of such character. No such suggestion has been made.

Fidelity never came under any Federal regulation. During its entire existence it was regulated by the State authorities. All of the deposits which were made were in pursuance to State laws. No reason whatsoever is shown why the Federal Court should have any jurisdiction to nullify the rights which have been thus created.

It is highly significant that the Securities and Exchange Commission in its report to Congress stated that neither of the two major companies (Fidelity Investment Association and Investors Syndicate) had registered their certificates under the Securities Act of 1933 "presumably by reason of the exemption in Section 3 (a) (8) of that Act." The footnote to said sentence points out that:

> "Sec. 3(a) (8) of the Securities Act of 1933 includes among the securities exempted from the registration and prospectus requirement of the Act, 'any insurance or endowment policy or annuity contract or optional

annuity contract, issued by a corporation subject to the supervision of the insurance commissioner, bank commissioner, or any agency or officer performing like functions, of any State or Territory of the United States or the District of Columbia.'"

Part Two, Statistical Survey of Investment Trusts and Investment Companies, p. 228.

Commissioner Healy, in his statement before the Sub-Committee of the Committee on Banking and Currency of the United States Senate, preceding the passage of the bill, compared these companies to savings banks (Part One hearings on S. 3580, pp. 33, 38).

Thus, until the enactment of the Investment Company Act of 1940, the Securities and Exchange Commission evidently held the view that investment companies selling face-amount certificates were exempted from the registration of their certificates under the Securities Act of 1933.*

Petitioners, for want of any better reason for the Central Trust Company's taking over the twenty millions of dollars worth of securities for distribution, say that it is better to wind up the company at Charleston in the Federal Court as that a lot of legal questions can be raised there. So far as we can discern from the petition this is the sole basis of their challenge of the finding of the Court of Appeals that the best interests of the contract holders would be subserved by the State proceedings. They naively assert:

"The prevalent theory of the States participating in this case is that the State deposits, except in West Vir-

*By the same token, it would seem that a face-amount certificate company would not be the type of corporation that could file a petition in bankruptcy, because it possessed the essential characteristics of an insurance or banking corporation. (Sec. 4 (b) of the Bankruptcy Act.)

ginia, are for the primary protection of the holders of the contracts sold in the respective States. This theory may, or may not, be sound. It should be judicially determined by a court having jurisdiction of all of the assets and of the persons interested before there is any distribution."

Then they go on to say that it is not for them to *answer* or *resolve* these questions *now* (one year after the taking of 4,000 pages of testimony covering the creation of the deposits with great detail), but that they are merely *making suggestions* demonstrating the necessity of witholding any distribution until they are settled.

What a windfall it would be to the Central Trust Company and its staff of attorneys (including those which have been loaned to the Debtor in their frenzied efforts to sustain this proceeding after the attorney who filed the petition evacuated the case) if this innocent-appearing little suggestion which "may or may not be sound" can be tested out at Charleston! Oh, what a scurrying there would be to find authorities to support elaborate pleadings raising the question of whether or not after all contract holders in Tennessee, Alabama, Kansas and the other States have any security, if only this Court would give them the green light. What a disaster it would be to eighty thousand contract holders who compare such subtleties of the law to the disputation of the ancient theologians about how many angels could stand on the point of a needle.

With liquidation in mind as the ultimate result of the litigation, petitioners say:

"Whether or not, if there should be liquidation, the assets should be distributed according to the States in which they are held and to the contract holders re-

siding therein, or according to the contract series funds for which Fidelity owned and held these assets, will be a real question which can be effectively determined only while the *res* is undistributed."

To prove that there can be no possible basis for the distribution of the deposits except the State laws under which they were created, it is necessary only to refer to the testimony of Mr. Raymond Latta. Before the receivership in the State Court, the company employed this expert actuary in an effort to devise some method of determining the "equities" of the contract holders with a view of effecting some rehabilitation. Mr. Latta remained in the employ of the Receivers and continued in the employ of the Trustee in Bankruptcy until September 15, 1941. (Record, p. 3223.) He was not called as a witness by the Debtor but was called as a witness by the defendants opposing reorganization. He had gone so far as to work out tentative or rough working plans. These were filed as Exhibits 111 and 112. (Record, p. 3255). One plan was called the Uniform Plan and the other the Graduated Plan. Under the Uniform Plan contract holders would receive 80 per cent or 85 per cent of their "equities." Under the Graduated Plan some of them would receive 90 per cent and the remainder would receive 30 per cent to 50 per cent. *Mr. Latta testified that no plan was ever devised which could be put into effect.* (Record, pp. 3305-3306). He attended conferences with the Securities and Exchange Commission. All of these plans looked to the company being transformed into a life insurance company. (Record, p. 3306).

Mr. Latta testified that it was impossible for them to determine the amount each fund had. This was because of the various loans and inter-fund transactions. After nine

months work on these problems, there were still questions which baffled this reorganization expert. For the convenience of the Court of Appeals, we are printing an excerpt from his testimony as Appendix C to this reply. This excerpt has been printed in the transcript of the record at pages 238-239.

The deposits in the several States in general secure the total liabilities in the States according to the laws of the State without distinction as to funds or series. No more power exists in this Court to readjust claims of contract holders between the different States so as to bring about a reshuffling of securities among the holders of the different series of contracts, than to take away the deposits themselves. This would be accomplishing by indirection what cannot be done directly.

The inescapable barrier to reorganization is the varying rights and interests of secured contract holders in the different States. It is unfortunate that there must be any loss. Still, since loss there must be, it should be borne where it falls. This Court cannot mitigate the misfortune of those having the lesser security by taking away any security from the better secured classes of contract holders. Moreover, the great complexity of interests would prevent the formulation of any fair modification of the existing rights of contract holders. Any such modification would have to be upon lines *wholly arbitrary*.

For the reasons given, no fair, equitable and feasible method of reorganization is possible in this case; and distribution of $20,000,000 of securities will have to be made according to State laws which required the deposits and govern the basis of distribution.

**Why Proceedings in Bankruptcy Not to Best Interest of Contract Holders.**

Whether we test the applicability of the Bankruptcy Act to Fidelity and the benefits expected to flow from it from the standpoint either of rehabilitation as a going concern, or liquidation, the same conclusion is inescapable.

Contract holders would suffer greatly from continued proceedings in bankruptcy because:

(a) Bankruptcy proceedings in this case would only serve to multiply and protract fruitless litigation and delay the payment of the just claims of contract holders; and

(b) A great amount of expense will be avoided if immediate liquidation of the State deposits in State Courts is permitted.

It has been shown that any litigation having the end in view of abrogating or modifying the State deposits as they existed at the time of the filing of the petition would be useless and detrimental to contract holders.

It is as plain as the noon-day that so far as Fidelity is concerned, no greater power over State deposits exists in the Bankruptcy Court since the enactment of the Investment Company Act, than there was before. We have seen that it was not the intention of Congress to disturb the State deposits as they existed on the effective date of the Act, which was January 1st, 1941. As Mr. Schenker stated to the Senate Sub-Committee on Banking and Currency, "meticulous care" was taken to see that those States which had deposits could hold on to them. (Printed Transcript, p. 229)

The Investment Company Act embodied a separate section headed "Bankruptcy of Face-Amount Certificate Companies." This Section 29 undertakes to amend Section 67 of the Bankruptcy Act so as to give the Bankruptcy Court summary jurisdiction over State deposits in proceedings for the *liquidation* of face-amount certificate companies.*

Section 29 expressly provides that it applies only to the deposit of securities made by a face-amount certificate company on or after January 1st, 1941. Deposits made prior to that time may not be avoided by the Trustee, and the Bankruptcy Court is given no summary jurisdiction of any proceedings to hear and determine the rights of any parties with respect to such deposits. It is to be borne in mind that all of the deposits of Fidelity were made prior to January 1, 1941.

That is not all. Sub-section (f) (5) of Section 29 provides:

> "Where the provisions of Sub-Section (c) of Section 28 are not applicable, the provisions of this Section shall not apply."

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*It is worthy of note that neither prior to the enactment of the Investment Company Act nor as a result of the amendment to that Acts was any *special* provision made for the *reorganization* of face-amount certificate companies. Whereas, the Bankruptcy Act contained separate chapters with carefully framed provisions concerning Agricultural Compositions and Extensions, Railroad Reorganizations, Debt Readjustments by Municipalities and Taxing Districts, Corporate Reorganizations, Arrangements, Real Property Arrangements and Wage Earners Plan, this simple amendment designed to facilitate the *liquidation* of face-amount certificate companies and the distribution of the deposits made after January 1st, 1941 was added by the Investment Company Act as an amendment to Section 67 of the Chapter relating to ordinary bankruptcy. It is in such striking contrast to the carefully detailed methods set up with respect to other types of corporations as to make it exceedingly doubtful whether in any event there would be jurisdiction in the Bankruptcy Court to attempt to *rehabilitate* a face-amount certificate company as a going concern. But this is not a determinative question.

Manifestly, it was intended that Section 29 relating to bankruptcy of face-amount certificate companies might have application to *some* companies but not to *all* companies.

Obviously, Section 28 referred to is the preceding Section of the Investment Company Act, the title of which is Face-Amount Certificate Companies. Sub-section (c) of Section 28 relates to regulations of the Securities and Exchange Commission applicable to deposits with trustees which may be required of *registered* face-amount certificate companies.

For two reasons, Section 28 (c) was not applicable to Fidelity, viz:

(a) According to the statement of the representatives of the Securities and Exchange Commission at the hearing, it was never a *registered* face-amount certificate company; and

(b) Sub-Section (g) of Section 28 rendered the entire Section 28 (including Sub-section (c) inapplicable to Fidelity because it provides that the Section shall not apply to a face-amount certificate company which on or before the effective date of the Act has discontinued the offering of face-amount certificates to the public. Fidelity did discontinue the offering of face-amount certificates to the public before the effective date of the Act.

We have shown that the assets of Fidelity outside of the State deposit are negligible; because as the record shows there is a claim of the Federal Government for unpaid income taxes in the amount of approximately $300,000.00, and after the payment of administration expenses, Court costs and attorneys' fees, very little, if anything, will re-

main from the non-deposited assets to be distributed to contract holders. To make the decision in this case turn upon the non-deposited assets or the possibility of some equity in one or more of the States to go back to the general fund would be putting the cart before the horse. Contract holders would be far better off to waive altogether their claims against the non-deposited assets than to let such a trivial amount control the disposition of Twenty Million Dollars of deposited securities held in State deposits.

Therefore, for all practical purposes, Fidelity's deposits, before the Investment Company Act was enacted, were not subject to the summary power of a court of bankruptcy. They did not become subject to such summary jurisdiction after the Act took effect. Indeed the failure of Congress to amend the reorganization sections of the Bankruptcy Act, when the Investment Company Act was passed is persuasive that it was not intended that those sections of the Bankruptcy Act so ill-adapted to the processes of reorganizing a face-amount certificate company would be resorted to. However that may be, when this company avoided the necessity of becoming a *registered* face-amount certificate company by discontinuing the offering of face-amount certificates to the public prior to January 1, 1941, it exempted itself from the only provision of the Bankruptcy Act which would have had direct application to the State deposits.

When consideration is given to the clear intent of Congress to leave the existing deposits undisturbed, it would not be consonant with justice to arrive at the result aimed at by the petitioners by resort to any forced or strained construction of the provisions of Chapter X of the Bankruptcy Act.

Surely there can be no gainsaying the following statement by the Court of Appeals:

> " . . . *certainly the possibility that thousands of contract holders could be persuaded to modify their contracts and scale down their claims to enable the company to go on is so remote as to exist only in the imagination. No proposal for the investment of new capital has been forthcoming.* The facts underlying the whole situation are so clear that even the parties in this case who insist upon reorganization under the Bankruptcy Act hold out little hope of a resumption of the business as a going concern, and content themselves for the most part with the argument that reorganization in the statutory sense includes 'a slow and orderly liquidation.' " (Italics ours).

**Immediate Need of Liquidation for the Benefit of Contract Holders.**

The Court of Appeals concluded that the immediate need was liquidation of the company's assets for the benefit of the contract holders. This was a *factual* determination. The evidence clearly sustains this conclusion.

It was developed at the hearing that the expenses of the receivership in the Federal Court at Charleston, before any allowance for administrative expenses, Federal Income Tax or the income from the deposited securities, Court costs, Trustees' fees and attorneys' fees was approximately $150,000.00 per annum. This is only a *part* of what it is costing contract holders to keep this proceeding in Court. (Tes. of J. H. Schellhase, pp. 2614-2620, typewritten record)

The statement in the opinion of the District Judge that the company's assets "might reasonably be expected to be largely dissipated in costs, fees, and market losses by forced liquidation" in a State Court proceedings, it seems to us, is wholly unwarranted. It is not amiss, we think, to make the observation at this point that from the standpoint of costs and expenses, the chief concern of contract holders is as to the following:

(a) The annual cost of $150,000.00 in administrative expenses of the trust estate while this litigation goes on;

(b) The compensation of the Central Trust Company and its attorneys and the multitudinous costs and expenses of this litigation in addition to the annual operating expenses of $150,000.00;

(c) The loss to contract holders from depreciation in securities already incurred since the litigation commenced, and the additional depreciation which will likely be suffered before the contract holders can get their money out of the insolvent concern;

(d) The large amount of additional income taxes that will accrue if the contention of the Federal Government is sustained that the estate must pay Federal income taxes on all of the income from the securities held in State deposits;

(e) Increased allowances to Receivers and attorneys representing contract holders and depositaries occasioned by reason of this proceeding;

(f) The untold amount of fees and expenses that will be incurred by contract holders for committees and attorneys in establishing and enforcing their rights if the estate has to be administered in Charleston, West

Virginia, and in a State far distant from the places where they reside and where the deposits securing their contracts are held;

(g) And what will be the most stupendous exaction of all the over-all fees on the whole $20,000,000.00 estate that may be allowed to the Central Trust Company in Charleston and the attorneys if the summary turn-over order directing that all State deposits be turned over to the Trustee is revived and a *slow* liquidation is conducted by the Trust Company at Charleston.

We do not feel that we can pass the discussion of this point, without observing that in this case there may be a *fast* and *orderly* liquidation in the several States. This is what the contract holders are entitled to. Fidelity is not the kind of corporation with which the Courts were dealing in the cases cited by the District Judge in his discussion of "slow" liquidation. We believe that it is a fair generalization that the assets of those corporations did not consist of liquid securities which were fairly readily marketable. The deposits of assets of Fidelity in the several States consist principally of bonds.

The Securities and Exchange Commission, in its Report on Investment Trusts and Investment Companies as to the type of investments made by the company, states: "The Association has followed a settled policy of investing its funds *almost entirely in marketable securities*, about ninety percent of which have consisted of bonds and notes." (Page 96 of Report) So far as we can recall, there is not an iota of proof that there will be any benefits to contract holders to whom these securities belong from having the

Central Trust Company (a moneyed corporation operating for profit) take over the deposits and reduce them to cash.

When petitioners speak of "slow liquidation", they really mean *slow distribution*. There would be some benefits from a slow distribution but those benefits would not inure to the contract holders. *They would be benefits to the Central Trust Company.*

## CONCLUSION.

There is no important question of Federal law involved in this case. Certainly there is no question of Federal law involved in this case which this Court should undertake to settle. Even if this Court should disagree with the reasoning of the Court of Appeals, on the question of whether or not Fidelity was an insurance company within the meaning of the Bankruptcy Act when the petition was filed, it possesses no such omniscience as to enable it to declare principles which would be controlling in every such case that may hereafter arise. Any attempt to do so would result only in confusion worse confounded.

The decision of the Court of Appeals is a *just* one. There is no reason for this Court to permit this litigation to be prolonged. A decision that Fidelity was a kind of corporation that could file a petition under the Bankruptcy Act and sustaining the petition which has been filed would only result in years of wasting of the contract holders funds, while the Central Trust Company and its attorneys enjoy a very luscious plum.

Servant girls, miners, policemen and letter carriers have turned over their savings to this company to be invested

for them. The fact that deposit laws of the various States insured protection for these payments was no doubt the chief inducement that was used in selling the scheme. These people scattered in some twenty-nine different States cannot afford to employ lawyers and set up Committees to save their securities from being consumed in an utterly futile attempt to continue the operations of this defunct company through proceedings in a Federal Court in a distant State. They will not understand how the company could sell the contracts on the strength of guaranties from every quarter that they need never look beyond the boundaries of their own State for protection against loss because of the "safeguards" of the State deposit and then resort to the aid of a Federal Court in bankruptcy to take their security away from them.

We submit that the underlying issue is one of *good faith*. Debtor's case should be scrutinized with extreme care lest the Federal Courts unwittingly be used as an instrumentality for breaking faith with many thousands of humble persons who are as sheep dumb before their shearers.

Respectfully Submitted,

WELDON B. WHITE,
FYKE FARMER,
RUDOLPH K. SCHURR.

## APPENDIX A.

## CHAPTER 209 OF THE PUBLIC ACTS OF THE GENERAL ASSEMBLY OF THE STATE OF TENNESSEE, ENACTED MARCH 8, 1939, APPROVED MARCH 10, 1939.

SECTION 1. Be it enacted by the General Assembly of the State of Tennessee, That Section 6057 of the Code of Tennessee be amended by adding at the end thereof the following:

"Provided, however, that if the Securities offered or to be offered for sale to Tennessee be of the class known as 'Investment Contracts', comprising the following: investment contracts, or annuity contracts other than those of qualified insurance companies, or installment investment certificates, or securities of like kind, which contemplate that the issuer shall pay or deliver, or whereby the issuer agrees to pay or deliver, either absolutely or conditionally, to the purchaser or holder of the contract, certificate, bond, or like security, a sum of money at a future time, either with or without interest, in consideration of a payment or payments made or contemplated to be made by such purchaser or holder, which securities are hereinafter referred to as investment contracts; the investment company, or issuer, domestic or foreign, upon written request of the Commissioner of Insurance and Banking of this State, shall deposit and maintain with the said Commissioner, for the benefit of the holders of such investment contracts, a deposit of securities in cash or its equivalent; but the Commissioner of Insurance and Banking may, in his discretion, accept as said equivalent, such securities as domestic life insurance companies are permitted to invest their funds in under Section 6204 as amended of the official Code of Tennessee, in amount not less than $10,000 and at no time less than 100% of the issuer's cash or current contracts, liability on all such outstanding investment contracts, as defined herein, sold in the State of Tennessee. The Commissioner of Insurance and Banking of this State shall hold as custodian the securities deposited for the benefit of the holders of the investment contracts coming within the provisions of this Section.

"Securities deposited may be withdrawn at any time by the issuer at its option whenever other securities of like character are deposited in equivalent amount with the Commissioner of Insurance and Banking of this State in substitution therefor, or to the extent of any excess over 100% of the aggregate amount of the issuer's said cash or current contract liability on all such outstanding investment contracts sold in the State of Tennessee, provided only that the amount of said deposit shall not be reduced by such withdrawal below $10,000 unless the issuer has ceased to sell the investment contracts for which the deposit is maintained and no longer has authority to sell the same in this State. The Commissioner of Insurance and Banking of this State shall permit a reduction of such deposit by withdrawal of securities as herein provided upon the filing by the issuer of a proper affidavit showing that the amount of such deposit is in excess of the requirements of this Section. Upon discharge in full of all liabilities on all investment contracts sold in the State of Tennessee and for which such deposit is maintained, the issuer shall be entitled to a release and return of the securities so deposited. The issuer making such deposit shall be entitled to collect and receive the income and/or payments made on securities deposited; provided, however, that the amounts unpaid on deposited securities shall at no time be less than the minimum amount required to be deposited hereunder.

"The Commissioner of Insurance and Banking shall at least annually and oftener if he may deem it proper, appoint a disinterested qualified person or persons to make an examination and appraisement of the securities deposited with him, to determine if such securities meet the requirements of this Section, and the cost of such examination and appraisement shall be borne by the issuer of the investment contracts being sold or offered for sale in this State."

SECTION 2. BE IT FURTHER ENACTED, That this Act shall take effect from and after its passage, the public welfare requiring it.

## APPENDIX A.

## CHAPTER 157 OF THE PUBLIC ACTS OF THE GENERAL ASSEMBLY OF THE STATE OF TENNESSEE, ENACTED FEBRUARY 14, 1941, APPROVED FEBRUARY 15, 1941.

**An Act to Make the State Treasurer the Custodian of all Collateral Held by or Deposited with the State or Any Department Thereof and to Fix His Duties and Responsibilities in Connection Therewith.**

SECTION 1. BE IT ENACTED BY THE GENERAL ASSEMBLY OF THE STATE OF TENNESSEE, That the State Treasurer be and he is hereby designated as the custodian of all collateral, securities, bonds and other valuable papers deposited with the State or any department thereof, and shall be exclusively responsible for the safekeeping thereof. It shall be the duty of each department head or other person in the State Government having in his or her possession collateral of the type above mentioned, to turn the same over to the State Treasurer upon the latter's request and to receive from the State Treasurer an itemized receipt therefor and as additional collateral, shall come into the hands of the department head or other person the same procedure shall be followed.

For the safekeeping of such collateral, the State Treasurer shall execute an additional bond in such sum as may be fixed by the Governor with the surety thereon to be approved by the Governor. He shall make an annual report to the Governor of the collateral in his hands, which report shall be made on or before December 15 of each calendar year. The expenses of such additional bond, if any, shall be paid from the appropriation made to the Treasurer's office.

SECTION 2. BE IT FURTHER ENACTED, That this Act shall take effect from and after its passage, the public welfare requiring it.

## APPENDIX B.

### (From Debtor's Petition for Reorganization.)

VII

Debtor further states that it now has outstanding investment and annuity contracts with reserve liabilities totaling approximately $25,000,000, and that in these contracts debtor agrees to pay interest accumulations of from four to five per cent per annum; that the decrease in interest rates in recent years has made it impossible for debtor to invest its funds in conformance with the West Virginia law and to earn the interest requirements as set forth in its said outstanding contracts; and that by reason of said interest requirements under its said contracts debtor is now suffering an annual loss of approximately $250,000 per annum, and that this loss will continue and probably increase unless the earnings on sound securities should increase far in excess of the present rate of income.

That for the reasons above set forth debtor has been unable to meet its obligations as they mature and will be unable to meet its obligations as they mature, *unless the rights of its contract holders are modified* so that the earnings received on securities and assets owned by debtor will be sufficient in amount to meet the requirements under its outstanding contracts; *and if the rights of its outstanding contract holders are modified to this extent*, debtor will be able to meet its reserve requirements and will be able to comply with the Investment Company Act of 1940 and will be enabled to resume the operation of its business.

Debtor further states that each of its existing and outstanding contracts is secured under the terms of each of its said contracts by a reserve fund, which is on deposit with the Treasurer of the State of West Virginia and *with the officials and departments of other states* where the securities of debtor were sold; and that the rights of *all* contract holders must be modified as above set forth in order that debtor may be permitted to obtain adequate relief, and that by reason of these facts debtor cannot obtain adequate relief under chapter 11 of the Bankruptcy Act.

## VIII

Debtor further states that no plan of reorganization has been as yet formulated, and that it knows of no plan of reorganization, readjustment or liquidation affecting the property of the corporation pending either in connection with or without any judicial proceeding except that receiverships have been created in West Virginia and other states, some of which are threatening to sell the assets now in their possession.

## APPENDIX C.

Excerpt from the Testimony of Raymond Latta, pp. 3252-3254:

"MR. PALMER:

Q. In any attempt, however, to rehabilitate the company before there were receivership proceedings, the fact that, let us say, the B fund had a 95% equity and the special annuity had, let us say, a 25% equity, was a difficult matter to work out. Wasn't that true? I mean, as a practical matter?

A. My experience there was they never determined what amounts each fund had. As far as working out a plan is concerned, it offered problems to what we were working toward, because we had no assumptions to make toward determining the equity of each fund.

Q. Let me develop that a little more fully. You attempted to find out how much equity or cash against liability each policy holder of each series of contracts would have. Is that correct—roughly?

A. Worked out statements of that nature revealing information of that nature, with innumerable assumptions made.

Q. What was that?

A. We tried to develop figures along that nature, with—making innumerable assumptions—a number of them, I mean.

Q. Part of the trouble was that you had loans between funds and transactions between funds as shown by the books of the company. Isn't that true?

A. Yes, sir.

Q. And you would have to assume in some instances that the loan would be paid back by one fund to the other fund before you would work on it. Isn't that right?

A. We made various assumptions.

Q. Yes! That was one of the assumptions you made.

A. Yes.

Q. And in other assumptions, you just took the reserve as shown by the books of the company as belonging to that fund, without paying back any of its loans in other funds and worked on that assumption.

A. We made various assumptions along that line; yes.

Q. You had no way, prior to receivership proceedings being brought, of determining which of your assumptions would be lawfully and legally correct?

A. Did you put a date in there? I can't answer that with a date.

Q. You had no way of determining that any of your assumptions was lawfully and legally correct?

A. I haven't heard the answer as yet, if that is what you mean.

Q. By that you mean the answer to the question is that you had no way of determining it?

A. That's right."



FILE COPY

In the

# Supreme Court of the United States

October Term, 1942.

No. 319.

FIDELITY ASSURANCE ASSOCIATION AND CENTRAL TRUST COMPANY, *PETITIONERS.*

*vs.*

EDGAR B. SIMS, ET AL.

ON PETITION FOR THE WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT.

## BRIEF ON BEHALF OF L. H. BROOKS, TRUSTEE, FREDERIC LEAKE AND A. L. GOLDBERG, JR., TRUSTEE, AND DEWEY S. GODFREY, RECEIVER FOR FIDELITY ASSURANCE ASSOCIATION IN THE STATE OF MISSOURI, IN OPPOSITION TO MEMORANDUM OF SECURITIES AND EXCHANGE COMMISSION.

WELDON B. WHITE,
FYKE FARMER,
*Counsel for L. H. Brooks, Trustee, Frederic Leake and A. L. Goldberg, Jr., Trustee.*

RUDOLPH K. SCHURR,
*Counsel for Dewey S. Godfrey, Receiver in the State of Missouri.*

BAIRD-WARD—NASHVILLE

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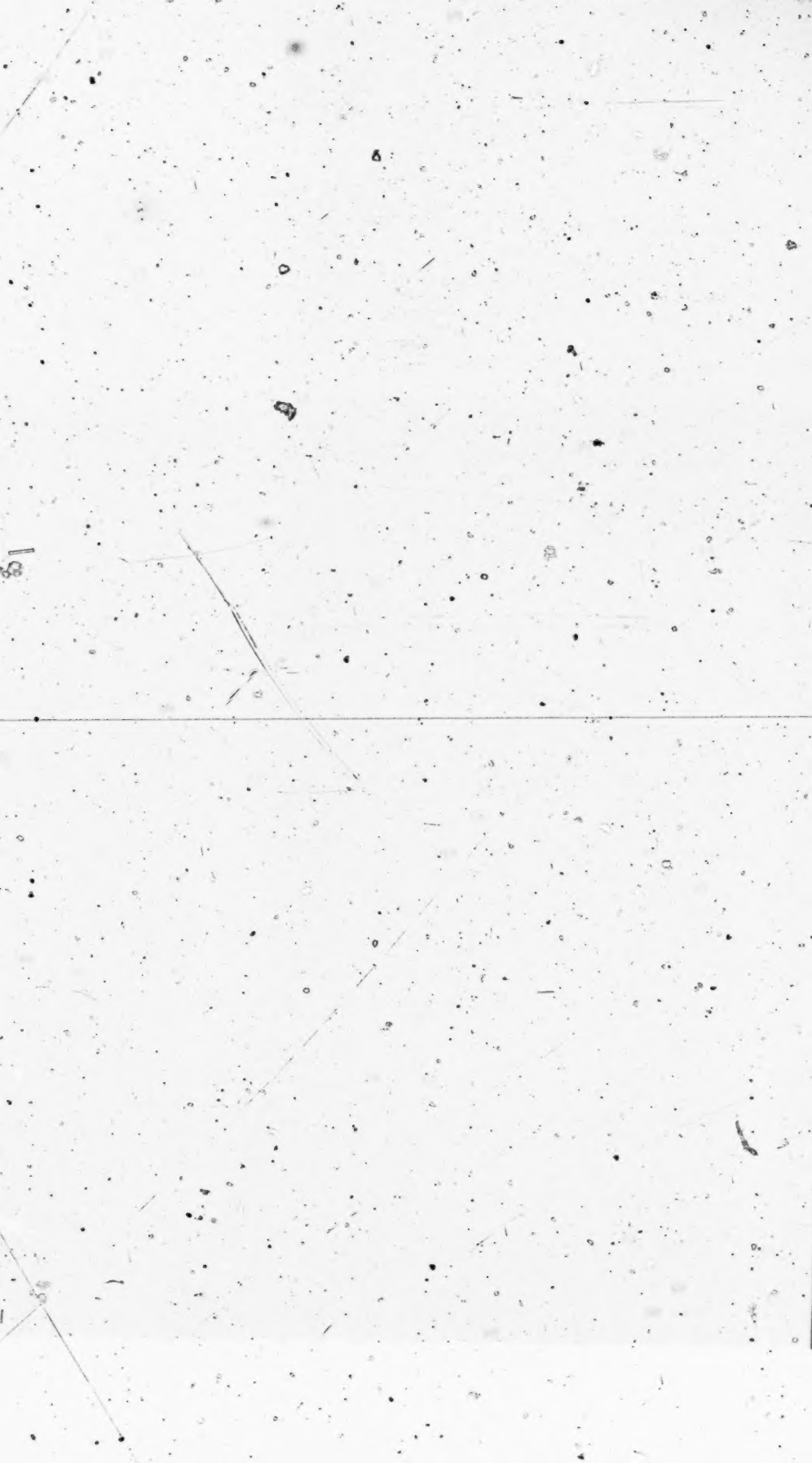

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*May It Please the Court:*

### NECESSITY FOR THIS REPLY BRIEF.

Securities and Exchange Commission has filed a memorandum for the purpose of supporting the petition of Fidelity Assurance Association and Central Trust Company. We feel that the writer of the memorandum has completely overlooked facts appearing in this record, nay evidence compiled by the Securities and Exchange Commission itself,

in its extensive investigation of Investment Companies, which conclusively refute all of the argument contained in the memorandum. The importance of these facts is such, we think, that the omission to give recognition to them leads inescapably to a partial and inadequate understanding of the case. Therefore, since we have no other way of exposing these fallacies, we feel that there is a duty resting upon us to bring these facts to the attention of the Court at this time by means of this reply brief.

## QUESTION I—THE INSURANCE QUESTION.

The Securities and Exchange Commission says that the first question raised concerning the correctness of the reasoning by which the Court of Appeal concluded that Fidelity Assurance Association was an insurance corporation at the time the petition was filed is of such importance in the administration of Federal statutes (the Bankruptcy Act and the Investment Company Act) that this Court should undertake to settle it. The reasoning on this point is grounded upon the assumption that it is important that this Court in this case announce a decision as to the applicability of these Federal statutes to other similar companies which have attracted the savings of a large number of persons throughout the United States for investment.

But, the argument goes further than this,—as indeed it must, if the point is to merit any consideration whatsoever —and recognizes that the question is as to the eligibility of such companies for *reorganization* under Chapter X of the Bankruptcy Act. It may seem strange that the writer of the memorandum failed altogether to make any attempt to show that this particular company, Fidelity Assurance Association, *could* or *should* be reorganized. The failure to

do so cannot be ascribed to mere oversight, inadvertence or lack of familiarity with the facts of the case on the part of the author of the brief; for the solicitor representing the Securities and Exchange Commission whose name is signed to the memorandum, in arguing the case before the Court of Appeals, admitted that in his opinion it was "almost" 100 per cent certain that Fidelity could not be reorganized as a going concern of any kind or character. Therefore, they are now driven to use the term "reorganization" with the meaning of liquidation.

Considerable emphasis is placed in the memorandum on the amount of "assets" of Fidelity (95 per cent of which are held in the State deposits), the number of contract holders, and the fact that they are scattered throughout the forty-eight States of the Union and the District of Columbia. It is hardly necessary, we think, to point out that this case may not be transferred from the field of litigation concerning private rights and interests into the field of public interest, merely on account of the amount of money involved or the interstate character of the company's operations. The public interests are not necessarily involved, because of the question made in this case, as to whether this company should be excluded from the Bankruptcy Act. No question of public importance could arise over the problem of distribution of the assets of this defunct company, unless the *principles* of the decision may vitally and materially affect other similar companies which in the future may be similarly situated.

In order to demonstrate, beyond the shadow of doubt, that a decision in this case settles no principles of law which can ever in the future have application to other similar companies, or to contract holders in those companies

whose rights and interests are similar to the contract holders in this case, it is necessary only to refer to the findings of the Securities and Exchange Commission itself, as set forth in its Report on Investment Trusts and Investment Companies. This Report is one of the exhibits in this case, sent up in original form.

We believe that Securities and Exchange Commission will readily agree that, for the purpose of the precise question under consideration, there is a clear line of demarcation between face-amount certificate companies and all other classes of investment companies. This distinction was carefully drawn in the Investment Company Act. It can serve no purpose to call attention to the fact that there are "other large financial institutions which have attracted the savings of large numbers of persons throughout the United States for investment." Our consideration must be limited to face-amount certificate companies as defined by the Investment Company Act.

Securities and Exchange Commission in its report on Investment Trusts and Investment Companies transmitted to Congress under date of March 13, 1940, sets out that there were then only three companies of this type. They were Investors' Syndicate, Fidelity Investment Association, and United Securities Company of Missouri. The report states that the first two occupy a "predominate position" in the field. (Report, pp. 2-3.)

The report further states that the United Securities Company of Missouri is the only other sizable corporation which, so far as available information indicates, offers face amount installment certificates or contracts to the public. It was pointed out in the report that the installment or

thrift certificates sold by this company did not fall in the same category as the face-amount certificates sold by the other two companies, which were the special subjects of the study embodied in this Report. It is stated in the Report that state officials apparently have not required deposits to secure certificate liability of United Securities Company of Missouri, because the face-amount certificates of that company were collaterally secured under trust agreements, and were, in effect, collateral trust certificates. (Report, pp. 121-124.) Manifestly, United Securities Company of Missouri, for the purpose of the question under consideration, is unlike Fidelity.

This leaves as the only other company which has sold face-amount certificates secured by deposits with state officials before the Investment Company Act went into effect, the Investors Syndicate. The District Judge, in his opinion, refers to this company, saying: "This regulatory law [The Investment Company Act of 1940] has not had the effect of banishing all such companies from the region of commercial operation. The testimony discloses that at least one other such company is still in operation, presumably with some measure of success." (Printed transcript, p. 29.)

Investors Syndicate, as the evidence in the case discloses, is the only investment company which has become a registered face-amount certificate company under the Investment Company Act of 1940. It has been operating in some manner as a registered face-amount certificate company since January 1, 1941, the effective date of that Act. It did not, so far as the proof discloses, undertake to transform itself into an insurance company prior to the effective date of the Act. Nor did it cease to issue face-amount cer-

tificates after the effective date of the Act. The status and characteristics of Investors' Syndicate is therefore now, at least in the respects noted, wholly dissimilar to the status and characteristics of Fidelity Assurance Association when the petition was filed.

Now, let us notice carefully the precise question which Securities and Exchange Commission says is of so great importance in the administration of Federal statutes that it ought to be settled by this Court. The question is not, as they say, merely as to the "eligibility for and amenability to corporation reorganization under Chapter X of face-amount certificates and other investment companies which procure incidental insurance power, making insubstantial use of them." (Memorandum of Securities and Exchange Commission, p. 11.) The question is inadequately stated in these terms. More exactly stated, the question is: whether or not a company which having, (a) over a period of years issued and sold face amount certificates which were secured by deposits of securities in trust, in accordance with the laws of the several states in which certificates were sold requiring such deposits to be maintained as a condition to the right to sell such certificates therein; (b) prior to the effective date of the Investment Company Act, became insolvent and found itself unable to comply with the requirements for a face-amount certificate company under that Act; (c) amended its charter so as to become an insurance company, and from and after that date did everything possible to become an insurance company, as distinguished from a face-amount certificate company, for the avowed purpose of avoiding compliance with that Act; (d) six months later, after having obligated itself as an insurance company on 9,802 insurance contracts and; (e) in this period received payments on outstanding face-amount con-

tracts previously issued which it could not lawfully have done as a face-amount certificate company because it did not register under the Investment Company Act but had a lawful right to do as an insurance company, was an insurance company within the meaning of Sec. 4(a) of the Bankruptcy Act when it filed the petition for reorganization under Chapter X.

This question has never arisen before. Obviously it will never arise again. The decision of this question settles nothing as regards Investors' Syndicate, the only other company which was even remotely comparable to Fidelity when the latter filed its petition for reorganization. For many reasons, unnecessary to be noted here, the decision of this question involves no principles which can have even indirect application to any problem of reorganization or liquidation of other corporations, sometimes loosely called investment companies. An inevitable consequence of an attempt by this Court to declare principles of law to govern in other cases which may arise in the future involving problems of reorganization or liquidation of other types of investment companies generally, would be that in each such case various questions of conflict between the decision of this Court in this case and the decision of Courts of Appeal would be presented. By taking jurisdiction to review the decision of the Fourth Circuit Court of Appeals in this case, this Court would be committing itself in advance to a review of most, if not all, of the cases which Securities and Exchange Commission envisage. This Court, in undertaking to review in this case, would not be *settling* any important question of Federal law; rather, it would be *disturbing* a just decision on an unimportant point of Federal law which can never again recur.

## QUESTION II—GOOD FAITH.

### Will Interest of Contract Holders Be Best Subserved by Proceedings for Reorganization, Under Chapter X?

The reasoning of the memorandum of Securities and Exchange Commission on this point, it seems to us, is predicated upon an incorrect assumption. The memorandum states that Fidelity kept books showing separately the status of the several series of face-amount certificates which it issued, and that particular securities acquired were allocated to the various funds. It further states that the state depositaries did not segregate the deposit of securities according to series, "even where they had notice of the particular series of contracts to which the deposited securities belonged." (Memorandum, pp. 4-5.) It is significant that identification of "they" is lacking. The only citation supporting this statement is to the opinion of the District Judge. These statements, it seems to us, are susceptible of an altogether erroneous implication—one that is not even warranted by the opinion of the District Judge.

The actual finding of the District Judge was:

> "In each of the contracts sold by the Debtor there was a provision, which is set out in the respective contracts as Section 1 thereof, whereby, with slight variation in language as to each particular class or series of contracts, the Debtor agreed to create and maintain a reserve fund for such particular class or series from payments made on contracts of that particular class or series, which reserve fund was to be used for the discharge of its liabilities on that particular class or series of contracts. On its books Debtor kept these various series funds separate and distinct, but prior to December 31, 1938, it deposited cash received from payments on all different series of contracts except

Series 'B' and Series 'D' in one bank account. Payments on contracts in Series 'B' and Series 'D' were deposited in separate bank accounts from their inception. At times when the reserve fund in one series was impaired by reason of withdrawals and maturities, so called 'interfund' loans were made, of which records were kept and on which interest was charged to the borrowing fund and paid to the lending fund. In making the deposits with the various state depositaries, *Debtor** did not at all times designate deposited securities as being owned by particular funds, and made no attempt to apportion its deposits of securities from a particular fund to the amount of cash liabilities against that fund in the state where the securities were deposited."

(Printed Record, p. 9.)

In view of the manifest earnestness with which Securities and Exchange Commission insists that there are difficult problems of distribution in this case which can best be settled in a single administration, we feel that the facts with reference to the creation of the state deposits should be brought squarely to the attention of the Court, and in somewhat more detail than in the opinion of the District Judge. Fortunately, the printed transcript, despite its incompleteness, embodies other portions of the typewritten record which will enable us to point out certain very important facts.

In the first place, no blame can be placed on the state authorities for the failure to segregate the deposited securities according to the various series funds. The state de-

* All italics herein are our own.

posit laws did not require such a segregation. The lack of such a requirement was not regarded as a justification for non-compliance with the state laws; for one of the allegations in the bill of complaint which Securities and Exchange Commission filed against Fidelity on December 14, 1938, was that the Association had failed properly to comply with these deposit requirements. The decree of the Federal court in the case, entered on December 22, 1938, enjoined the Association, among other things, "from purchasing and depositing with West Virginia or any other state; insufficient securities or securities which do not meet deposit requirements, or failing to segregate and maintain at all times sufficient statutory deposit against appropriate liabilities." (Report of Investment Trusts and Investment Companies, p. 131.)

Although an unequivocal admission that the purpose or reason for the various changes in the certificates sold was the existence of deficits in reserve funds of the anterior series, could not be obtained from any of the officers of the company who testified, this inference is clearly warranted. No good reason was given by any of the officers who testified for the minor variations in the different types or series of contracts as they were made from time to time.

Provisions in each of the different series of contracts, with slight and immaterial difference in verbiage, obligated the company to create and maintain a special fund for the discharge of its liability under the particular series of contract. The reserve fund was to be set aside from payments received on account of the particular series. By the *express* provisions of each of the series of contracts, this reserve fund was to be invested in approved securities, and *deposited in trust as required by the laws of the State of*

*West Virginia.* There would be no difficulty in performing the obligations both to create and maintain the separate reserve fund from the payments from the particular series of contracts, and to maintain the required deposits in trust with the state officials, as long as the company had sufficient securities—or, in other words, was solvent. Difficulty in fulfilling both the requirements arose as soon as the company became insolvent.

For many years prior to the investigation made by Securities and Exchange Commission, however, Fidelity had failed to segregate and apply separately cash payments received from contract holders having the different series of contracts. It set up on its books an account which it called a General Fund. Apparently, this was a sort of conduit through which it, as frequently as the need arose, shuttled securities acquired from one series to cover deficits in the other series.

Fidelity's financial difficulties first commenced in 1929 and 1930. At that time the securities account amounted to over $30,000,000.00, and there was about $5,000,000.00 or $6,000,000.00 depreciation. (Testimony of D. A. Burt, Printed Record, p. 270.)

The affidavit of Ben E. Jackson, an accountant-investigator for Securities and Exchange Commission, filed in the action brought by Securities and Exchange Commission against Fidelity Investment Company in the District Court of the United States for the Eastern District of Michigan in December, 1938, states:

> "The books and records of defendant reflect that from November 9, 1920, defendant has issued and sold to the general public about 200,000 contract certificates

for a total face amount of approximately $600,000,000.00 as follows (to June 30, 1938):

| *Number of Contracts* | *Series Contract* | *Total Face Value* | *Period of Sales* |
|---|---|---|---|
| 38,504 | Special Income | $113,330,000 | November 1920-April 1925 |
| 21,843 | Special Annuity | 268,218,000 | April 1925-February 1932 |
| 24,759 | Income Reserve Series A | 60,465,000 | March 1932-June 1934 |
| 47,811 | Income Reserve Series B | 102,126,250 | June 1934-June 1938 |
| 10,457 | Income Reserve Series D | 20,690,400 | July 1935-June 1938 |

As at June 30, 1938, 112,542 of these certificates were outstanding with a total face value of $276,223,450.

"Each series of contracts sold calls for the creation and maintenance of Reserves and Special Funds for the benefit of a particular class of contract holders. Special Funds include an Active Fund for each series, and a Maturity and Retirement Reserve Fund for Special Annuity, Income Reserve, Series A; Income Reserve, Series B, and Income Reserve, Series D, contracts. The Special Income contracts call for the creation and maintenance of a Special Income Paid Up Fund. For each Fund the contracts call for the purchase and deposit in trust with the Treasurer of West Virginia underlying portfolio securities as delimited by the West Virginia code or statute which regulates the conduct of the business of defendant.

"The Books of defendant do not reflect the creation and maintenance of Maturity and Retirement Reserve Funds for Special Annuity, Income Reserve Series A, Income Reserve Series B, or Income Reserve Series D Contracts, or a Special Income Paid-Up Fund until September 30, 1937. *Prior thereto, these Reserves and*

*their assets were commingled with assets in defendant's General Fund, but with certain securities earmarked as belonging to Income Reserve Series B and Income Reserve Series D Maturity and Retirement Reserve Funds."*

(Report on Investment Trusts and Investment Companies, pp. 236-237.)

Mr. Jackson's affidavit also sets out that the total of the deficits in the various contract funds on June 30, 1938, was $3,497,052.12, and further summarizes Fidelity's juggling of the different series funds as follows:

"The defendant does not require physical segregation as to special Contract Funds of portfolio securities deposited by it with the Treasurer of West Virginia. This enables defendant to make substitutions and to effect interfund sales or transfers of securities, without notification to or the approval of the West Virginia authorities. Defendant has at various times failed to purchase and deposit in trust sufficient bonds and other securities as required and delimited by the laws of West Virginia and the terms of the various contract securities issued by defendant. Defendant has purchased and deposited with the Treasurer of West Virginia bonds and other securities in default or which did not and do not meet the requirements of the West Virginia statute. Defendant has failed to maintain at all times a sufficient deposit with the Treasurer of West Virginia and with other state officers and agencies as required by the laws of said states and by the terms of the contract securities issued by said defendant.

*Defendant has deposited, in states requiring deposit, securities belonging to Special Contract Funds in excess of the liability of said Funds to contract holders residing in said states; using the excess to cover in part or wholly the liabilities of other Contract Funds; although representing to prospective purchasers: 'Securities Deposited with State Departments In Accordance With Legal Requirements In Each State in Which We Operate.'"*

IX

"*For many years defendant has failed to segregate and apply separately cash payments received from specific classes of contract holders.* Continuing this practice, defendant now does commingle in one common bank account all monies paid in by persons holding Special Income, Special Annuity, and Income Reserve Series A Contracts, with the monies of defendant's General Fund. Defendant permits overdrafts between the various Contract Funds and between the General Fund and the various Contract Funds. Before 1933, no interest allowances were made to the lending Funds. These overdrafts are in violation of contract and statutory requirements as to investment and deposit. Due to these overdrafts, at times the General Fund was indebted to various Contract Funds in amounts in excess of $2,000,000, while at the same time said General Fund was operating a speculative Margin Trading Account in securities with New York City Brokers. From defendant's books and records and from defendant's daily report of bank balances, submitted daily to sixteen of its principal officers and directors, it appears that cash has been and is now being disbursed for the defendant's General Fund and

for various Contract Funds without regard to whether each of said Funds has a cash balance to its credit.

"Interfund overdrafts reached a peak total of approximately $5,000,000 as of September 30, 1936. At this time defendant's General Fund was indebted to various Contract Funds in the amount of approximately $2,000,000, and the Special Income Active Fund was indebted to other Contract Funds in the amount of approximately $3,000,000. These overdrafts were covered, so far as the bank was concerned, by defendant's drawing against cash balances to the credit of the Special Annuity Active Fund and the Income Reserve Series A Active Fund. As at December 31, 1937, interfund overdrafts between all funds Contract and General totaled $2,351,513.99, and as at June 30, 1938, $2,071,751.14.

"Various officers and directors stated in their sworn testimony that the above overdrafts resulted because certain Contract Funds had insufficient cash on hand to meet contract maturity, cash surrender, and loan demands. According to the testimony, overdrafts were essential because the 'borrowing' Contract Funds could not liquidate sufficient underlying portfolio securities to meet cash demands, without suffering such heavy losses as to impair the solvency of the Contract Funds and the capital of defendant.

"As of December 31, 1937, the Special Income Active Fund was short $756,744.87 in its cash account and the Special Annuity Maturity and Retirement Reserve Fund was short $1,585,734.83. The underlying portfolio securities of these funds are carried by defendant at a 'book' value very substantially in excess of the then market value. If underlying portfolio securities were sold from these funds to cover cash overdrafts,

defendant would have to contribute cash equal to the loss, or difference between book and market value. Defendant's capital surplus and earned surplus at this time on its books amounted to $488,204.61. As of December 31, 1937, the difference between book and market value of the underlying portfolio securities of the Special Income Active Fund and the Special Annuity Maturity and Retirement Reserve Fund aggregated respectively $758,756.66 and $717,424.77. The only source from which defendant could make up realized losses in the various Contract Funds is from Defendant's General Fund. However, for the past several years and to date, defendant has pledged practically all of the marketable securities of its General Fund with the various states to cover deposits deficiencies in the various Contract Funds. If the General Fund should withdraw such deposited securities from the various states for the purpose of sale, other equivalent securities necessarily would have to be deposited. As of December 31, 1937, practically no such additional securities acceptable for deposit were available from any source.

"As of June 30, 1938, and as of October 31, 1938, the position of defendant and the various Contract Funds in these respects remained practically unchanged. As of November 23, 1938, defendant's 'independent auditors,' Wilson and Meredith (C.P.A.'s, Ohio), in commenting in their audit report for the month of October, 1938, pointed out the existence of the above-mentioned facts and questioned the practice of defendant's commingling the cash of various Contract Funds; of defendant's permitting the practice of interfund and General Fund Overdrafts; and of defendant's commingling of securities for the purpose of

deposit with various States. It was suggested that defendant take steps to correct the conditions resulting from said practices.

"The above situation explains why defendant has failed to maintain at all times the required reserves against existing contract liabilities, on a market basis, and why defendant has failed adequately to restore by contribution from the General Fund deficiencies existing at various times in specific Contract Funds."

(Report on Investment Trusts and Investment Companies, pp. 240-242.)

Mr. Hubert F. Young, who had charge of purchasing securities for Fidelity, and distributing the securities for deposit with the various states, called as a witness by the Debtor, testified in part as follows:

"Q. Generally how did you distribute these securities which were transmitted by you for deposit to the various states under their respective state laws? A. We always asked the states to approve the deposit before making the shipment.

Q. Was there any reference to the allocation of these deposits to any specific contract fund? A. No, not until recent dates.

Q. All right. And now, from 1932 up until say—when? 1939? A. '38 or '39.

Q. '38 or '39. You transmitted the securities for deposit in the various states, as required by them under their state statutes, without reference to segregation? A. That is correct.

Q. (Continuing) Of these securities to specific contract funds. Is that right? A. That is correct.

Q. But since 1938 you have made an effort to accomplish that, have you? A. Yes, we have."

(Printed Transcript, p. 215)

"(The Court) Mr. Young, explain why it was that you found it impossible to make deposits to cover the annuity contracts? A. Because we had them in other states who would not let us withdraw them, for instance, in West Virginia. We had to keep certain securities down here, and the Auditor of West Virginia or the particular officer in any state would hardly let you withdraw from that state to put them in another state, and we were short that much. The annuity account, of course, is one of the insolvent accounts, and *there was simply not enough securities to go around.*"

(Printed Transcript, p. 217)

Mr. J. H. Scheilhase, an actuary and accountant for the company, testified as follows:

"Q. And it was not until the liability on that series of contracts in that particular state was substantially below the deposited amount that a request would be made by the company for the withdrawal of deposited securities? A. Well, I don't know—the only time that I recall—and I am not certain about it—is that the only time we requested the states to take down some of those securities was in 1939. *Most of the time I would say those securities were held out there for the increasing number of payments probably of some other contract fund, so that the deposit was maintained at all times either by that particular contract fund or by another fund's securities.*

(The Court) Let me ask you this. There were a number of funds shown on your own book, but your deposit in the state was just one deposit, wasn't it, and not separated into funds? A. I think that is—I don't know for sure about that, but I think it was just one deposit in a state.

Q. Then, even if one fund did accumulate a surplus in a state, if some other fund was short, you couldn't get back any money from the fund that had a surplus could you? A. No, unless we would put up securities of the same value in the fund that was short."

(Printed Transcript, p. 213; italics ours)

Mr. Frank J. McNulty, Secretary of the Company, testified in part as follows:

**"Cross Examination.**

By Mr. Farmer:

"Q. You mean by showing segregation by series that in some of the reports in showing the liabilities in the states you list special income so much, and special annuity so much, Series A, Series B and so forth, so much, and then show the total, but you don't mean that you broke down and said these assets over he. were for special income and these for Special Annuity and these for Series A—you didn't do that in the Tennessee Reports, did you? A. We were talking about the audit reports.

Q. I thought you were talking about the reports to the state? A. No, this is the audit report.

Q. Oh! you are talking about the audit report? Is that it? A. Yes.

Q. And not the certificates that you sent to these state officials? A. Well the certificates were also broken down by funds.

Q. That is what I said, in the liabilities, but not a corresponding breakdown by deposit of securities? A. Well, in some states it was filed that way.

Q. Yes, but you don't mean that was the general practice, and you have outlined the special instances where that was done? A. Yes.

(Mr. Farmer) That is all."

(Printed Transcript, pp. 222-3)

After the Detroit injunction, Fidelity had annual audit reports prepared by the auditing firm of Haskins & Sells. The descriptive booklets embodying this report which were filed with the state officials, contain separate financial statements of the different series of funds. It was plainly stated, however, that the securities shown on the books of the company as being held for the different funds, because of state deposit laws, were not necessarily held for the funds. Three of these descriptive booklets were filed in the record as Exhibits 85, 86 and 87. We are not able to quote the exact language of the note with reference to the state deposit laws because we do not have a copy of the printed transcript, nor a copy of the descriptive booklets. Note 4 on page 11 of Exhibit 85, however, sets forth the statement plainly showing that such segregation as was made, according to the books of the company, were subject to the state deposit laws.

Mr. Arthur Koontz, general counsel for Fidelity Association, testified that his firm was consulted from time to time about the notes to be put in the auditors' report, explanations to be made, etc., so that there would be no violation of the injunction issued by the Federal Court in Detroit. Mr. Koontz states that these notes were submitted to representatives of the Securities and Exchange Commission before the booklets were published, and that he and Mr. Clark, the manager of Haskins & Sells, made a special trip to Washington to discuss this matter with the Securities and Exchange Commission. (Typewritten Transcript, pp. 3582-3588.)

We do not mean to suggest that Securities and Exchange Commission is in any way censurable for the failure of Fidelity to avoid violation of the Detroit injunction; for, as Mr. C. E. Smith, who was assistant secretary and a director of the company, admitted, although every effort was made to comply with the order, it was "very likely" that the company was unable to do so because of its condition of insolvency. (Typewritten Record, p. 1322.)

It seems to us therefore, that the foregoing clearly shows that no neglect of duty or wrong-doing is imputable to the state officials having custody of the state deposits. In the first place, there was no duty resting upon them to segregate deposited securities by contract series. In the second place, even if there had been some duty, they could not have been expected to perform the impossible. Plainly, prior to the investigation of the company by Securities and Exchange Commission, little or no effort was made by the company to make such segregation by funds. After this investigation by Securities and Ex-

change Commission, separation was impossible by reason of the company's insolvency. Neither situation in any way derogates against the state deposits. *It was because of just such a possibility which might entail serious loss to contract holders that the state deposit laws were enacted.*

We pointed out in our brief in opposition to the petition, that the validity of the state deposits had not yet been challenged in this litigation. Even now the memorandum of the Securities and Exchange Commission contains no suggestion of any grounds on which the validity of the state deposit laws can be brought into question.

Therefore, we are at liberty to proceed with the examination of Securities and Exchange Commission's argument on its Point II by assuming that *legally* no distribution of the securities held in state deposits (amounting, as Securities and Exchange Commission concedes, to 95% of the total "assets") could be made without giving full recognition to the deposit laws of the several states. But Securities and Exchange Commission insinuates that it must first be determined whether the state deposits are solely for the benefit of local residents and not for the benefit of all contract holders. What does this mean? Does it mean that by some inexplicable process all of the state deposits are to be brought into hodge-podge? No reason is given why this could or should be done. Inasmuch as it seems to us that it is beyond the pale of possibility that the rights of contract holders may be so far ignored as to bring all the deposited securities into one general pot with the general assets of Debtor, so as to make all contract holders merely general creditors, we will confine our further discussion to a demonstration

of the fallacy underlying the next insinuation made by Securities and Exchange Commission with respect to the state deposits.

Securities and Exchange Commission in its memorandum further pose this question:

> "(d) it must be determined whether states which accepted deposits from Fidelity to secure contracts in a particular Fidelity series, with knowledge that the securities deposited constituted a fund belonging by contract to another series may keep such assets.
>
> "It is obvious that security holders from states without deposits or states with inadequate deposits must litigate these questions in each of the fifteen states having deposits, unless there is to be a central administration in a court of bankruptcy."

Surely Securities and Exchange Commission does not mean that such questions are inevitable. No such issue is in the case at the present time. There is no reason why such a question should ever be made, regardless of whether the state deposits are distributed by the states in accordance with the decree of the Court of Appeals, or whether there is to be some kind of administration of these deposits in a court of bankruptcy. Such litigation would only be fruitless and expensive to contract holders, because there is no possibility of any re-shuffling or redistribution of the state deposits at this time on the basis of such bookkeeping entries as were made by the company with respect to the different series of funds.

We showed in our brief in reply to the petition that *valid trusts* came into existence when the securities were

deposited according to the state deposit laws. Now, we wish to show the obverse of this—that no valid trust came into existence at any time until the deposits of securities were made by the company with said depositaries. This means, of course, change of possession, actual or constructive.

Until the Company transferred securities to the State depositaries, they were still (notwithstanding bookkeeping entries) under the unfettered dominion and control of the Company. They should be "switched" about from one ledger account to another. They could be "loaned," or "advanced." The record shows many such transactions in very large sums. There was no attempt even to make separate bookkeeping entries until the latter years of the Company's existence.

The different contracts themselves when analyzed furnish conclusive evidence that no trust could come into existence until securities were deposited with State officials. In the first place, the contract holder was to make his payments *to the Company*. Undoubtedly the payments when received by the Company became its *absolute* property. The company agreed unconditionally—so far as reserve funds were concerned—to make the payments to the contract holder when due according to the terms of the contract. It did not agree to pay only *out* of the separate reserve fund. The contract holder's right to receive the payments from the Company was not limited to any special or segregated fund.

At no time throughout the whole period was there a trust fund or *res* until the Company parted with posses-

sion of securities by delivering them to the various depositaries.

*McKey* v. *Paradise*, 299 U. S. 119, 81 L. Ed. 75;
*American Service Company* v. *Henderson* (4 C. C. A) 120 F. (2d), 525;
*Continental Casualty Company* v. *Powell* (4 C. C. A) 83 F. (2d), 652.

The legal impediments to the attempt to redistribute the securities held in state deposits, according to the various contract series, are as great as those barring an attempt to completely abrogate the state deposit by throwing all of the securities into hodge-podge. Moreover, there is no evidence whatsoever in the record tending to show that there is any possibility of making such a redistribution of the deposited securities on any fair or reasonable basis. So not only is there the *legal impossibility* of doing what the Securities and Exchange Commission timorously imply may be done, but there is such a *mathematical impracticability* as to be tantamount to an *impossibility*.

There is no evidence in the record tending to show that it is possible to make such a re-allocation of the securities as would be required. The evidence was taken on the issue of whether there is a reasonable chance of *reorganization*. Debtor sought to show that the company could be *rehabilitated*. The insistence that a plan of "slow and orderly liquidation" would meet the requirements of Section 146 (3) of the Bankruptcy Act was injected in the case as an afterthought.

None of the auditors or accountants who investigated the affairs of Fidelity for Securities and Exchange Commission were called as witnesses. The only disinterested

witness possessing the necessary qualifications to testify on the subject was Mr. Latta. Judge Moore asked him the question whether or not it would be *possible* to prepare a plan of reorganization for Fidelity from an *actuarial* standpoint. The answer of the witness was in the affirmative. Judge Moore, however, refused to permit any of the counsel for parties opposing reorganization to ask the witness whether or not, in his opinion, it was *probable* as distinguished from *possible*, that a plan of reorganization from an actuarial viewpoint could be worked out. (Typewritten transcript p. 3511.) He further declined to permit the witness to answer the question whether it was *unreasonable* to expect that a plan of reorganization for Fidelity could be effected. (Printed Transcript, pp. 179-180; typewritten record pp. 3353-3374.)

Mr. Latta, however, later was permitted to make some explanation as to what he meant in his response to the Court's question, and we quote from his testimony as follows:

> "MR. PALMER: Q. Mr. Latta, will you please explain your answer to the Court's question when he asked you if Fidelity could be reorganized actuarilly—I don't know the exact question, but you answered the Court's question 'Yes.' Would you explain your answer, please? A. Actuarilly whether it could be reorganized strictly from a mathematical viewpoint, as I interpreted his question to be, would be as to whether there could be computed, as far as figures are concerned, in order to place this Company in a solvent condition, ready for operation on a sound financial basis as of that time. That is my interpretation of what he meant."

* * * * *

"MR. PALMER: Q. In other words, whether or not you could possibly construct an actuarial plan for Fidelity and your answer to that bears no relation to what your answer would be as to whether Fidelity could be successfully rehabilitated, is that correct? A. They are entirely separate questions.

"Q. And bear no relation to each other? A. No. (Printed Transcript, p. 184.)

Mr. Latta further testified that the various loans and interfund transactions rendered it impossible to determine what amount each series fund had. (Printed Transcript, pp. 238-239; Typewritten record p. 3568.)

A fair epitomization of his testimony as to the inextricable confusion of the different series funds is:

". . . as far mathematically speaking, you cannot determine the exact solvency of any fund due to the problems that are presented, you might say." (Typewritten record, p. 3274.)

Granting that some readjustment between series funds is physically and mathematically possible, how could it be done on any basis that is not wholly arbitrary? When the Detroit injunction was made the Company had around $28,000,000 in State deposits. (Report on Investment Trusts and Investment Companies, p. 130.) After this injunction in 1939 the surrenders were heavy (printed transcript, p. 212). During the two years that the company operated after the Securities and Exchange Commission enjoined it from failing to segregate funds, it lost around $8,000,000 from withdrawals by contract holders. It was insolvent during this time. It did not and could not segregate funds. It followed the old

policy of robbing Peter to pay Paul. So, even if a trust relationship with respect to each series contract could by enforced—and we have already demonstrated the unsoundness of any such theory—some Special Annuity contract holders for example, have been paid with series B monies. This money cannot be recovered. What about the millions which were turned back to contract holders before any bookkeeping separation by series was attempted? (Report on Investment Trusts and Investment Companies, pp. 108-109.) Too much water has already run over the dam to try at this late date to attempt any readjustment of this labyrinthine maze of figures on any now-as-for-then basis.

Had the issue of the possibility of a re-allocation of the securities between the different contract series been raised in the case before the hearings were concluded, it would have been easy to demonstrate in more detail why such a thing is unthinkable. If we suppose that it would be possible for auditors, accountants and actuaries after innumerable court hearings and appeals, to *construct* records for the many thousands of contract involving millions of dollars that were issued before the company commenced keeping records for each series separately, the first question that arises is, Will any of us now in the litigation live to see the task finished? The company operated two years after the Securities and Exchange Commission enjoined it from such activities and didn't do it. Mr. Latta worked on these problems seven months and couldn't do it. We feel safe in saying that the chances of such a thing ever being done can only be represented by a fraction not unlike Prof. Montague's, which had a numerator of 1 and a denominator which stretched from here to one of the fixed stars.

Litigation over these questions will not arise if the states are permitted to proceed with the liquidation and distribution of the deposits. It cannot be shown that any class of contract holders would benefit from the raising of such questions. The average claim of each contract holder is $250. Who would be willing to trade his chance for a certain 80% payment immediately for *any kind* of payment which might be promised to him five or ten years from now? Contract holders would choose the bird in hand even if somebody else should offer to pay the lawyers' fees for all the litigation—and wisely and prudently so.

The argument of Securities and Exchange Commission on this point, it seems to us, begs the question. The proposition is that the federal court has jurisdiction not because the best interests of contract holders will be subserved by liquidation through a simple administration in a court of bankruptcy. It is that the federal court has jurisdiction because *questions* can be raised in a court of bankruptcy that cannot or will not be raised in the states where the deposits are held. There is no showing that there will be any benefit to contract holders from a determination of these questions. There is no showing that the questions must *inevitably* arise before there can be a distribution of the state deposits according to the state laws. No attempt is made to show that even if a bankruptcy court has jurisdiction and the questions are raised, the best interest of contract holders will thereby be subserved.

The questions do not exist in the case now. Jurisdiction depends on the questions being raised. They can be raised if there is jurisdiction. Therefore there is jurisdiction. Around and around we go in the circle.

Since the questions are not now in issue, they do not say that the Court can settle them now. All they ask is for permission to go back to the District Court. There they can be raised and bruited about for a season. Eventually, of course, they will land in this court. Years and years from now they will be settled. We submit that the final judgment then would be that the state deposits must be upheld as they were when the petition was filed.

The further point is made that the Bankruptcy Court must determine whether the local deposit is for the benefit of the contract holders who resided in the state when the contracts were sold; who resided there when the deposits were made, or who now reside in the state. The evidence utterly fails to show that these questions possess any substantial importance.

It is said in the petition that in five states the local statutes exclude non-resident contract holders from participating in the local deposit. The memorandum fails to show which five states are referred to. We cannot speak as to the laws of the other states, because we have not studied all of them. The Tennessee statute, however, clearly secures only those contracts sold in the State of Tennessee. We are constrained to believe that there is little or no ambiguity in the other statutes. Granting that there may be a few cases where questions will arise as to whether or not a particular contract holder is entitled to share in a particular state deposit, there is no reason why such possibility should be determinative of this case.

Some twenty million dollars is now held in state deposits which contract holders need and want. The distribution of this entire amount should not be held up in order that

questions which may possibly come up as to a few thousand dollars can be determined in a bankruptcy court rather than in the state where the questions arise. If a claim is disputed, it will be a very simple matter to pay dividends on the other claims and set aside a fund to cover the disputed claim. In this case we think our guess is as good as the other fellow's. We imagine that no controversy of this nature will arise as to 99-44/100% of the amount of deposits.

---

Again it is said that the bankruptcy court ought to have jurisdiction so that it can be determined whether the measure of claims is the cash value of the contract, the reserve value, the amount necessary to mature the contract, the amount paid in, or some other amount. At the same time, it is conceded that there is little probability of a surplus in any state except Wisconsin. To state an example: In Tennessee, the amount of deposit, according to the testimony at the hearing, is less than the total of the claims. No contract holder in Michigan, West Virginia or any other state will have any claim against the Tennessee deposit. What difference will it make to contract holders in any of the other states whether the basis of distribution in Tennessee is the cash value of the contracts, the reserve value, or any other amount or value? These questions affect only the contract holders in Tennessee among whom the deposit is to be distributed. Since there is a certain amount to be distributed among Tennessee contract holders, the amount of a possible claim which Tennessee contract holders would have against the West Virginia deposit is limited to the difference between the amount of the deposit and the aggregate of the claims. Say that difference is $25,000.00. It makes no difference, so far as the rights of contract holders in West Virginia and the other states

against the West Virginia deposit are concerned, which group of Tennessee contract holders have the claim.

The best interests of the contract holders will be subserved by a simplification of the issue, the cutting of red tape, and the elimination of technicalities. The contract holders would rather get 80% of their claims now than 85 or 90% ten years from now. Having purchased their contracts in reliance upon Fidelity's representations that the contracts were secured by deposits in accordance with the state laws, all the contract holders will feel that justice has been done when their rights are determined by their own state courts. None of them want anything that belongs to contract holders in any other state. It is impossible to see how any contract holder or any class of contract holders could benefit from the paltry but protracted litigation which Central Trust Company and Securities and Exchange Commission hold in prospect in the Bankruptcy Court.

## CONCLUSION

When this litigation was commenced, the proponents of reorganization had it in mind to disregard the state deposits. Hence, the turn-over order of June 9, directing that all state deposits be delivered to the Central Trust Company. It has gradually dawned on them that such a thing could be done. All questions now have been winnowed from the case except the trivalities which have been glossed since the Court of Appeals dismissed the petition.

The distribution of the securities belonging to the contract holders of Fidelity will not be cumbersome and difficult unless we purposely make it so. About $10,000,000.00 of the securities, or one half of the amount involved, is held in the West Virginia deposit. The other one half is held in thirteen other states. By reference to the schedule of deposits shown on page 225 of the printed transcript, it can readily be seen that four states—Alabama, Iowa, Missouri and Wisconsin—have apparently adequate deposits to cover liabilities in those states. These deposits aggregate about $3,500,000.00. Six states—Delaware, Illinois, Kansas, Kentucky, Maryland and Tennessee—are apparently 75% or better secured. The aggregate of the deposits in those states is approximately $4,800,000.00.

Therefore, in the ten states mentioned about $8,300,000.00 can be distributed among contract holders forthwith if the proceedings in bankruptcy are dismissed. There is no reason why the West Virginia Courts cannot determine the rights of the claimants to the West Virginia deposit as expeditiously as the Bankruptcy court can. We see no reason why the larger part of the West Virginia deposit cannot be paid out forthwith among the contract holders on the basis of admitted rights and claims, reserving

enough to make final settlement after the determination of the rights of all claimants.

It only makes the problem sound difficult and involved to mention the fact the contract holders reside in all of the forty-eight states. The table showing the geographical distribution of certificates in force (Report on Investment Trusts and Investment Companies, p. 166), shows that in most of the states the claims are inconsequential. It is reasonable to expect that few contract holders in the better secured states would go to the trouble of filing claims against the West Virginia deposit. This would result in the realization by contract holders in the states having the lesser security of a larger percentage of their claims.

There is no reason why any contract holder need expect to get less than 75% of his claim if distribution is made immediately on the basis of the state deposits before the funds have been diminished by losses, fees and expenses. It cannot be demonstrated that there is any possibility of any group of contract holders faring better by distribution in Bankruptcy.

At this particular time many contract holders have an urgent need for their money. It will entail serious hardship and loss to the contract holders to postpone distribution of millions of dollars while the lawyers wrangle over a congeries of points concocted out of the law of permutations and combinations. Since the decision of the Court of Appeals, the states have been going ahead with procedure for distribution, preparing to send out claims, etc.

The hopes of the contract holders of getting their funds released have been aroused. Justice will be done only by

making payment to them on the same basis on which the contracts were sold and which they have counted on for all these years—the safeguards of the state deposits — and without further delay.

Respectfully submitted,

WELDON B. WHITE

FYKE FARMER

RUDOLPH K. SCHURR

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microcard

# In the
# Supreme Court of the United States
## OCTOBER TERM, 1942

## No. 319

FIDELITY ASSURANCE ASSOCIATION, a corporation, Debtor, and CENTRAL TRUST COMPANY, Trustee for Fidelity Assurance Association,

Petitioners,

v.

EDGAR B. SIMS, Auditor of the State of West Virginia, and Ex Officio Insurance Commissioner of the State of West Virginia; ROSS B. THOMAS and H. ISAIAH SMITH, West Virginia State Court Receivers; BANKING COMMISSION OF WISCONSIN; CHAS. R. FISCHER, Commissioner of Insurance and Permanent Receiver for debtor corporation in and for the State of Iowa; JOHN B. GONTRUM, Insurance Commissioner of the State of Maryland; DEWEY S. GODFREY, Missouri State Court Receiver; L. H. BROOKS, Trustee, FREDERICK E. KE and A. L. GOLDBERG, Jr., Trustee; and SECURITIES AND EXCHANGE COMMISSION,

Respondents.

ON WRIT OF CERTIORARI
TO THE UNITED STATES CIRCUIT COURT OF APPEALS
FOR THE FOURTH CIRCUIT

# BRIEF OF RESPONDENTS, BANKING COMMISSION OF WISCONSIN AND CHAS. R. FISCHER, COMMISSIONER OF INSURANCE AND PERMANENT RECEIVER FOR THE STATE OF IOWA


JOHN E. MARTIN,
Attorney General, State of Wisconsin
J. JAMES WARD RECTOR
Deputy Attorney General, State of Wisconsin
RICKARD H. LAURITZEN,
Assistant Attorney General, State of Wisconsin
Attorneys for Respondent
Banking Commission of Wisconsin
JOHN M. RANKIN,
Attorney General, State of Iowa
FLOYD PHILBRICK,
First Assistant Attorney General, State of Iowa
CARL J. STEPHENS
BEN C. BUCKINGHAM
Attorneys for Respondent,
Charles R. Fischer, Commissioner of Insurance
and Permanent Receiver for Debtor Corporation
In and For the State of Iowa


THE GILMAN PRESS, MADISON, WISCONSIN

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In the

# Supreme Court of the United States

## OCTOBER TERM, 1942

**No. 319**

FIDELITY ASSURANCE ASSOCIATION, a corporation, Debtor, and CENTRAL TRUST COMPANY, Trustee for Fidelity Assurance Association,

Petitioners,

v.

EDGAR B. SIMS, Auditor of the State of West Virginia, and Ex-Officio Insurance Commissioner of the State of West Virginia; ROSS B. THOMAS and H. ISAIAH SMITH, West Virginia State Court Receivers; BANKING COMMISSION OF WISCONSIN; CHAS. R. FISCHER, Commissioner of Insurance and Permanent Receiver for debtor corporation in and for the State of Iowa; JOHN B. GONTRUM, Insurance Commissioner of the State of Maryland; DEWEY S. GODFREY, Missouri State Court Receiver; L. H. BROOKS, Trustee, FREDERIC LEAKE and A. L. GOLDBERG, Jr., Trustee; and SECURITIES AND EXCHANGE COMMISSION,

Respondents.

ON WRIT OF CERTIORARI
TO THE UNITED STATES CIRCUIT COURT OF APPEALS
FOR THE FOURTH CIRCUIT

# BRIEF OF RESPONDENTS, BANKING COMMISSION OF WISCONSIN AND CHAS. R. FISCHER, COMMISSIONER OF INSURANCE AND PERMANENT RECEIVER FOR THE STATE OF IOWA

On October 12, 1942 this court granted certiorari to review a decree of the Circuit Court of Appeals for the Fourth Circuit, reversing an order of the United States District Court for the Southern District of West Virginia dated January 5, 1942. The order of the District Court had sustained the petition for reorganization of Fidelity Assurance Association, the debtor, and had overruled certain motions of the respondents Insurance Commissioner of Maryland, L. H. Brooks, Trustee, Frederic Leake and A. L.

Goldberg, Jr., Trustee, and Edgar E. Sims, Auditor of the State of West Virginia and ex-officio Insurance Commissioner of the State of West Virginia, Ross B. Thomas and H. Isaiah Smith, West Virginia State Court Receivers.

## OPINIONS BELOW

The opinion of the District Court is reported in 42 F. Supp. 973. The opinion of the Circuit Court of Appeals is reported in 129 F. (2d) 442.

## JURISDICTION

The jurisdiction of this court rests on Section 240 (a) of the Judicial Code (28 U. S. C. A., sec. 347) and Section 24 (c) of the Bankruptcy Act (11 U. S. C. A., sec. 47 (c)).

## STATEMENT OF THE CASE

### A. Nature of the case and the procedural facts

On June 6, 1941 Fidelity Assurance Association, the debtor herein, filed a petition for reorganization under Chapter X of the Bankruptcy Act in the United States District Court for the Southern District of West Virginia (R. 4-9), and on June 6, 1941 that court entered its order approving the petition as properly filed (R. 1-4). Thereafter the Banking Commission of Wisconsin (hereinafter referred to as the Wisconsin respondent) filed its answer controverting said petition (R. 48-56), and Charles R. Fischer, Commissioner of Insurance and Permanent Receiver for Debtor Corporation in and for the State of Iowa (hereinafter referred to as the Iowa respondent) also filed his answer controverting said petition (R. 118-124). Answers controverting debtor's petition were also filed by

the respondents Edgar B. Sims, Auditor of the State of West Virginia and ex-officio Insurance Commissioner of the State of West Virginia, and H. Isaiah Smith and Ross B. Thomas, West Virginia State Court Receivers (hereinafter referred to as the West Virginia respondents) (R. 58-83); L. H. Brooks, Trustee, Frederic Leake and A. L. Goldberg, Jr., Trustee (hereinafter referred to as the Tennessee respondents) (R. 96-102); and Dewey S. Godfrey, Receiver in the State of Missouri (hereinafter referred to as the Missouri respondent) (R. 91-93). The Insurance Commissioner of Maryland (hereinafter referred to as the Maryland respondent) appeared specially and filed motions to strike out or rescind certain orders entered in the District Court on June 6, June 10 and August 9, 1941, directing certain state officials, including the Maryland respondent, to turn over certain property to the federal trustee and enjoining them in certain particulars (R. 124). The West Virginia respondents (R. 93-96; 124-127) and the Tennessee respondents (R. 128-130) also filed similar motions in the District Court with respect to said orders.

A trial of the issues presented by debtor's petition and the controverting answers and motions of said respondents was had in the District Court. On January 5, 1942 the District Court entered its order formally approving the debtor's petition for reorganization and overruling the motions of the West Virginia, Tennessee and Maryland respondents relative to the District Court's orders of June 6, June 10 and August 9, 1941.

The respondents appealed from said order to the Circuit Court of Appeals for the Fourth Circuit, and on June 16, 1942 the Circuit Court reversed the order of the District

Court and directed that debtor's petition for reorganization should be dismissed.

The debtor and the federal trustee petitioned to this court for a writ of certiorari to the Circuit Court of Appeals, and the writ was granted under date of October 12, 1942.

**B. Respondents' joint statement of facts**

This statement is made by and on behalf of all of the respondents herein except the Securities and Exchange Commission and for convenience is incorporated in this, the brief of the Wisconsin and Iowa respondents. It is designed to give as complete a picture as practicable, from the record herein, of the debtor's business and of these proceedings as affect the interests, generally, of all such respondents. Additional statements of fact as particularly affect the interests of each of the several respondents will be found in their respective briefs.

The pleadings and certain portions of the testimony have by stipulation been printed as the record in this court. The original exhibits have not been printed and are on file in this court. The references herein to the pleadings and testimony will be to the pages of the printed record in this court, and the references to exhibits will be to the original exhibit numbers of such exhibits together with the page of the record as printed in this court where such exhibits are admitted in evidence. In some instances the record as printed omits reference to the introduction of exhibits, and in such cases we have referred to the page of the original transcript where the exhibit is admitted in evidence as "R. — (original))." Certain exhibits and other material are printed in the Appendix to this brief, to which reference will be made as "(App. —)."

**1. Debtor's corporate charter and amendments thereto**

Fidelity Assurance Association was organized under the name of Fidelity Investment and Loan Association under the laws of West Virginia on April 11, 1911. In 1912 its corporate purposes were enlarged to include the business of soliciting or receiving payments on annuity contracts, and by virtue of this amendment it became subject to the provisions of Art. 9 of Ch. 33 of the Code of West Virginia relating to the business of selling "annuity contracts" and was licensed and supervised by the Insurance Commissioner of West Virginia as an annuity company until January 1, 1940. Art. 9, Ch. 33, the Annuity Company Law, was repealed by Ch. 46, Acts of the West Virginia Legislature, passed March 8, 1941, effective ninety days thereafter. Other amendments to the articles were made in 1926, 1929 and 1931, all as shown by Ex. 20 (R. 398).

**Amendment of December 31, 1940**

On December 31, 1940 the debtor amended its charter, changing its name from Fidelity Investment Association to Fidelity Assurance Association. It also struck out Art. 3 of its charter as amended in December, 1912, which contained a statement of its various corporate purposes as above outlined and inserted in lieu thereof, as the complete statement of its corporate purpose, the following:

> "To issue insurance upon the lives of persons and every insurance appertaining thereto and connected therewith, and to grant, purchase and dispose of annuities." (Ex. 24, R. 437, App. 76)

**Amendment of January 24, 1941**

On January 24, 1941 the stockholders of the debtor further amended its charter reducing its authorized capitalization to $1,000,000 of common stock of a par value of $8 per share, the total outstanding stock to be reduced to $2,210,744 of common stock with a par value of $8 per share. In the resolution of amendment it was stated that the reason for this reduction was that at that time the company was "qualified and admitted to transact a life insurance business in the state of West Virginia only" and that it was desired to further extend the territory in which the company might operate such business and that it was necessary that the stock of the company should be common stock of all one class and be reduced to such an amount as would leave a surplus after deducting those assets of the company which were not admitted as such by the insurance departments of the various states in which it was desired to do business. (Ex. 20, R. 398) A more detailed statement of the circumstances of the debtor's conversion into a life insurance company will be made later on in this statement of facts.

**2. The "Fidelity plan" in operation from December, 1912 to December 31, 1940**

Up to December 31, 1940 the debtor's business was that of selling its so-called investment or annuity contracts. At one time it was licensed in 29 states. Specimens of the various contracts which it issued comprise Exs. 1 to 5 (R. 170 (original)) inclusive. From time to time the form of the contracts was changed in certain particulars, but generally speaking, the "Fidelity Plan" provided for the issuance and sale of certificates whereby the purchaser

agreed to make monthly payments, in most cases for 120 months, of a definite sum of money and Fidelity agreed to return to the purchaser at the end of the monthly payment period a certain sum of money known as the "face amount" of the contract. This sum was to be paid in various annual, quarterly, monthly or other periods in accordance with the particular optional settlement plan elected by the contract holder. A sum considerably smaller than the "face amount" would be paid in a lump sum at the end of the ten year period, but after the expiration of the "waiting period" as referred to in the District Court's opinion. Each series of contracts contains extremely detailed provisions as to the rights of the contract holders with respect to payments, cash surrender values, lapsation upon failure to make payments and various optional plans of settlement. The contracts did not provide for any cash surrender or loan value until from ten to sixteen monthly payments had been made (p. 81 of Ex. 6, R. 1749 (original)) and if the contracts were lapsed at any time during these periods the contract holder forfeited to Fidelity all of the payments made. (Exs. 1 to 5, inclusive, R. 170 (original)) The contracts had to be carried for a period varying from six to nine years before the cash surrender value would be equal to the payments which had been made (p. 82 of Ex. 6, R. 1749 (original)). Exhibit 6 comprises the Report of the Securities and Exchange Commission on Companies Issuing Face Amount Installment Certificates made pursuant to Section 30 of the Public Utility Holding Company Act of 1935, hereinafter sometimes referred to as "SEC report." After all of the payments had been completed there was a waiting period varying from four to fourteen

months before payments to the contract holders would commence (p. 80 of Ex. 6, R. 1749 (original)).

Prior to 1922 certain contracts known as the "Old ten-year Series" and Series D and C had been sold but apparently few if any of these are now outstanding (R. 304). At this time the company's total assets were only about $2,000,000 (R. 307). In 1921 the sale of the special income contract (Ex. 1, R. 170 (original)) commenced and this continued up to 1925, but there are only about 900 holders of these today (R. 304). This contract was discontinued because of litigation with the state of Illinois, the Secretary of State having objected to it on the ground that it was possibly misleading (R. 305-306) and the "Special Annuity Contract" (Ex. 2, R. 170 (original)) was formulated (R. 306) and sold up to 1932. This was a period of tremendous growth for the company, its assets by 1932 amounting to in excess of $25,000,000 (R. 308). In 1932 the "Special Income Contract" was formulated and this was sold up to 1934.

In 1934 Fidelity commenced the issuance of the so-called Series B contracts and the sale of these contracts comprised practically its entire volume up to the time when it suspended the business of selling contracts late in 1940. The Series B contracts were issued in two types—one the regular form and the other having an insurance protection feature which was set forth in sec. 6 of the contract and made operative at the election of the purchaser (Ex. 4, R. 170 (original)). The insurance feature provided, for an additional charge, that upon the death of the purchaser prior to the maturity of the contract a sum would be provided sufficient to pay the contract to maturity or to pro-

vide a so-called commuted value of a paid-up contract to the purchaser's estate. According to the SEC report (p. 114 of Ex. 6, R. 1749 (original)), the yield on the Series B contracts was as follows:

| Mode of Settlement | With Insurance Value | With Insurance Yield Percent | Without Insurance Value | Without Insurance Yield Percent |
|---|---|---|---|---|
| (1) Cash surrender value at end of 126 (total) monthly-installment payments | $1,015 | 1.34 | $1,075 | 2.41 |
| (2) Cash maturity value 129 months after due date of first monthly installment | 1,030 | 1.55 | 1,090 | 2.56 |
| (3) 10 annual payments, after maturity, of $125 each | 1,250 | 2.82 | (a) | 3.38 |

Seventy-five per cent of the Series B contracts sold carried the insurance feature (R. 681). Series D contracts were sold in Ohio, Kentucky and Alabama because the authorities in those states would not permit the sale of the Series B contracts with insurance unless the company qualified as a life insurance company (R. 315).

(a) Amount not shown

**3. Fidelity a "compulsory savings" plan**

As has been shown the net return to investors under the Fidelity plan was not large and they stood to lose all of their investment if they did not make at least twelve monthly payments and it was not until they had paid continuously for from six to nine years that the contracts had a cash surrender value equal to the amount of the payments made. Furthermore, it appears that only 5.29% of the persons who purchased Fidelity contracts carried them to maturity (R. 388). The record amply bears out the statement in the SEC report (p. 106 of Ex. 6, R. 1749 (original)) that "The experience of purchasers of the Association's investment certificates appears to be unsatisfactory as a whole." According to that report the loss to contract holders by reason of surrender and lapsation during the ten year period, 1927-1936, was $7,510,000 (p. 92 of Ex. 6, R. 1749 (original)). During that period the certificates which matured equaled only 14% of the amount of certificates in force at the beginning of the period (p. 11 of Ex. 6, R. 1749 (original)). Forty-seven per cent of the purchasers failed to carry the contracts for as much as one year (R. 783). F. J. McNulty, the debtor's vice-president, stated he could not say whether or not more than 2% of all those who had paid their money into Fidelity had gotten it out at maturity (R. 391).

Despite these figures, which are not disputed, those of debtor's officers who testified during the proceeding stoutly maintained their faith in the Fidelity plan as providing a means for small wage earners in the United States to put in operation a beneficial plan of savings. The lapsation losses, far from being regarded as in derogation of the "Fidelity plan," were regarded as providing a spur and

incentive to the contract holders to continue payments, which were lacking in other investment plans. John Marshall, Sr., a director for twenty years, chairman of the Board for several years, general counsel, and voting trustee for the majority of stock (R. 410), stated that he understood from Mr. Paull (his father-in-law and one of the original founders) that he "thought there was a great need (for the Fidelity plan) because of his banking experience; that a great many people opened savings accounts but did not continue them" (R. 417).

D. A. Burt, a director, stated that even though the contracts did not have a cash surrender value equal to the amount of payments until they had been carried for many years, since they were sold with that understanding as expressed in the contract, he didn't "think there is any injustice done to anyone" (R. 710-711). The fact that only 5% of the contract holders carried their contracts to maturity did not alter his views (R. 712). The fact that "every month I got a little reminder on my desk that it was time for me to pay $10 or $7.50 into this Fidelity contract" seemed to him to be a very favorable factor in the plan (R. 713). As the District Court interpreted Mr. Burt's testimony:

> "It is not so much a question of a reminder as a question of compulsion on the part of the contract holder to pay or lose what he had paid" (R. 713).

The element of compulsion as being the salient feature of the plan was emphasized by L. H. Pulfer, who had been vice-president of Fidelity in charge of recruiting and building up the sales organization and who was later in charge of sales in the Chicago territory which was composed of a

number of states (R. 513). He stated that the principal appeal of the plan was "it offered that element of compulsion which would get a man to do that particular thing which otherwise he probably would not do" (R. 523). Without further elaboration it may be stated that the sole economic justification for the existence of Fidelity seems, in the opinion of its officers and principals, to be that it offered a plan of "compulsory savings" (R. 557). It was particularly emphasized that nothing advantageous was claimed by way of interest return (R. 523, 557).

The SEC report which comprises Exhibit 6 of the record herein deals in the greatest of detail with Fidelity's business and also with the business of the two other companies which are apparently the only other concerns which have been engaged in any substantial way in this peculiar type of business in this country. It may be stated categorically that an examination of this report and the record in the present case reveals conclusively that the experience of investors with Fidelity and with the other companies selling these certificates has been anything but a happy one. Tables on pp. 112-113 of Ex. 6 compare the relative advantage to an investor over a ten year period in placing like sums at like intervals in a savings account, in United States Savings Bonds and in a Fidelity contract. Considering the fact that the greater percentage of Fidelity's purchasers lapsed their contracts either in the first year or in the first few years, and thus lost all or a great part of their investment, the advantage of either of the first two forms of investment over that of Fidelity is obvious.

**4. The sale of the contracts**

From 1925 to 1934 Fidelity's sales were in the hands of a corporation known as National Sales Agency, Inc. (R. 514) which was owned by Fred King and A. L. King (R. 514) who were also dominant figures in Fidelity. Prior to 1925 National Sales Agency handled sales in the eastern territory and a firm known as Irving and Sisson, the western territory. Ex. 34 (R. 515) shows the number and geographical distribution of contracts outstanding as of April 10, 1941. This exhibit indicates that as of that date there were 87,999 contracts outstanding, but it was testified by Mr. McNulty, the secretary and vice-president of the company (R. 407), that on that date the number of "active" contracts (meaning those upon which regular payments were being continued) was between 22,000 and 25,000. According to Ex. 34 (R. 515) the cash liabilities on the contracts outstanding as of April 10, 1941 were $23,475,068.67.

In the operation of the "Fidelity plan" a substantial part of the contract holders' payments were applied to "loading" to pay sales expense. This "loading" amounted to the entire first eight months' payments on the Series B contracts, and over the entire life of the Series B contracts, 13.7% of total payments on insured contracts and 9% of total payments on uninsured contracts (p. 82 of Ex. 6, R. 1749 (original)). In 1935, when Carroll D. Evans took over the sales management, the company had about 20 offices and 400 salesmen and the volume of sales was $1,000,000 of face amount per month (R. 921-922). From 1935 to 1940 the offices increased to about sixty in number with 1,800 salesmen in all (R. 926). The turnover of salesmen was extremely high, more than 80% per year (R. 927), and the recruiting of salesmen was one of the most important

phases of the company's activities (R. 927-929). In order to get one acceptable producer it was necessary to interview 100 men (R. 929).

Despite the loading charges, National Sales Agency, Inc. became indebted to Fidelity in the amount of $1,000,000 by reason of advances made by Fidelity to that corporation upon unearned commissions (R. 384). This debt was never repaid and was transferred to certain subsidiary corporations of Fidelity (R. 769-770). After 1934 the company organized its own agency division to take over the sales which were formerly in the hands of National Sales Agency, Inc. (R. 515). Various sales officers of Fidelity who testified in this proceeding insisted that impressive and expensive offices in the principal places were Fidelity operated were a necessity in order that prospective salesmen might be favorably impressed (R. 923-924). However, despite constantly increased sales effort and expense the company consistently lost money.

The debtor's petition for reorganization (R. 7) alleges that it is suffering an annual loss of $250,000 and that this rate of loss will continue and probably increase unless the earnings or its invested securities should increase far in excess of the present rate of income. Prior to June 6, 1941, the date of filing of the petition for reorganization, all of the Fidelity sales offices had been closed and its sales organization completely dissipated and lost (R. 346-349). In 1938 or in the early part of 1939 the company's license to do business was suspended in most of the states where it did business (R. 393), and it is not now licensed in any state. It was estimated that it would take around $500,000 to recruit a new sales force which would provide adequate sales to continue operations (R. 933-934).

**5. State deposits the basis for sales**

The fact that Fidelity was subject to strict regulatory laws and had deposited securities thereunder to secure its obligations was a most potent sales point. The deposit laws were "the fundamental selling principle" (R. 917). The selling point in West Virginia was that "that fund would be available and under the control of the State Auditor in the event of any liquidation of the company," according to Mr. Risley, the president (R. 917). The West Virginia law "was one of the features that was stressed" (R. 921). The sales pamphlets and reports sent to contract holders made detailed reference to the state laws. In Ex. 37 (R. 852 (original)), a sales pamphlet showing the manner in which Fidelity purported to select its portfolio of investments, it was said that the securities selected were "deposited with state departments for the exclusive protection of contract holders." In Ex. 38 (R. 853 (original)) under the heading, "The exacting law under which the Association operates," sec. 3, Art. 9, Ch. 33 of the West Virginia Code was quoted. Ex. 39 (R. 853 (original)) states, under the company's financial statement, the following:

> "Securities deposited with state departments in accordance with legal requirements of each state in which we operate."

Ex. 106 (R. 1034) used in Wisconsin, contains pictures of the state capitol there and quotes portions of the Wisconsin deposit law. The company also used brochures showing pictures of the vault in the West Virginia state capitol (R. 605) and, according to Auditor Sims, sought to give out "that the state of West Virginia was behind the contracts" (R. 605-606).

### 6. The supervision of Fidelity by Edgar B. Sims, Auditor and Ex Officio Insurance Commissioner of West Virginia

It is in its relationship with the Auditor and ex-officio Insurance Commissioner of West Virginia that the long existing moribund condition of Fidelity is most clearly disclosed. Edgar B. Sims first was elected to this office in 1933 and he still holds it (R. 434). Upon his becoming acquainted with the affairs of Fidelity which were under his jurisdiction, he found that "the company was in the red in market values about $7,000,000" (R. 442). Auditor Sims had general supervising jurisdiction over the company by virtue of Art. 9, Ch. 33, West Virginia Code (repealed March 8, 1941) and under sec. 3 thereof, he, as Insurance Commissioner, was to require and approve the deposit with the State Treasurer by Fidelity, of bonds and securities to be held in trust for the benefit of its contract holders located in West Virginia to an amount equal to the cash liability of West Virginia contract holders. In addition he was to require and approve a deposit in trust for the benefit of contract holders located in states other than West Virginia to the extent that the laws of such states did not provide for a deposit equal or greater than that provided for by the laws of West Virginia. Soon after taking office he discovered that Fidelity's liabilities far exceeded the market value of its assets and also discovered advances by Fidelity to National Sales Agency, Inc. of $957,000 (R. 440). He was assured, however, that the note was perfectly good (R. 440). He told Fidelity that it must operate within the loadings provided by the contracts for commissions so that this note would be reduced. The officers told him that they were obeying him but they did not obey (R. 440) and he found that the advances had increased by $90,000 by the

end of the year (R. 440). In 1934 he insisted that Fidelity should take over the sales agency bank account or he would close Fidelity's business and the company complied with this order (R. 441). He called a meeting of the directors in Washington, D. C., and insisted that with the $300,000 to $500,000 per month which the contract holders were paying in Fidelity should buy bonds that had not defaulted during the depression in interest or principal, which were being sold at a discount at that time (R. 441). This policy appeared to work satisfactorily for a time due to a great rise in market prices, so that Auditor Sims could state that whereas the company was in the red in market values in 1933 about $7,000,000 "in market value today it is in the red only 2¼ million dollars" (R. 442). Auditor Sims ordered the company to cease renting expensive offices for the various sales managers but he had extreme difficulty in having this done (R. 442). He stated that the only reason the company was able to exist during the period from 1933 to 1940 was by the purchase of securities on a low market which had subsequently risen in value (R. 444), that the only way that the contracts could be sold were by means of what is known as "high pressure salesmanship" and that the expense of selling by this method was too great (R. 444).

Auditor Sims stated that, based upon his experience as auditor and his knowledge of the affairs of Fidelity, he did not believe the company could be reorganized in West Virginia "with the corpse of this one" (R. 449-450). He doubted very sincerely whether anyone could operate a face amount certificate company successfully in view of present economic conditions (R. 450). He believed that even with good management Fidelity would have been

unsuccessful because "they promised too much in their contracts and the economic change in interest rates, money rates, wouldn't stand that" (R. 453). The present outstanding contracts would have to be modified and he believed that the "structure of the company economically and financially was unsound from the beginning" (R. 453-454). Even if it was run economically he felt it was condemned, stating that, "I think they were quarreling with Ray's arithmetic all the time back there" (R. 454). He had thought that the company could be mutualized and turned over to the contract holders because there is nothing left for the stockholders, but the sort of plan he had hoped to work out was very thin and nebulous (R. 457). The situation apparently appeared desperate to Auditor Sims in November and December, 1940. At that time he ordered the stock trusteed in the hands of disinterested parties, but they did not answer his letter (R. 458). Finally he filed suit through the office of the Attorney General of West Virginia (R. 459) to which further reference will be made.

**7. Regulation of Fidelity by states other than West Virginia**

Fidelity was at one time licensed in 29 states and each of these states had regulatory laws governing the operation of its business (R. 347). Fifteen of the states in which it did business, including West Virginia, had laws requiring a deposit of securities to secure its outstanding contracts and the remainder of the states did not require a deposit, but the contracts sold in those states were secured by the deposit made with the state of West Virginia (R. 348). Ex. 48 (R. 1116 (original)) contains a list of the states having deposit laws, the market value of securities on deposit in each (as of June 6, 1941), the "net reserve liability" in

each and the "net cash liability" in each which is (as of April 10, 1941), according to Fidelity's figures, as follows:

| | Deposits by States as of June 6, 1941 | Liabilities by States as of April 10, 1941 | |
|---|---|---|---|
| | Market Value | Net Reserve Liability | Net Cash Liability |
| Ala. | $ 32,555.16 | $ 32,267.31 | $ 31,346.71 |
| Del. | 293,790.63 | 300,074.88 | 290,175.36 |
| Ill. | 3,759,894.00 | 4,368,348.52 | 4,225,790.75 |
| Ind. | 162,863.44 | 398,336.17 | 386,173.45 |
| Iowa | 45,082.50 | 35,332.03 | 34,478.27 |
| Kansas | 83,337.50 | 111,530.90 | 108,784.89 |
| Ky. | 86,712.50 | 95,376.98 | 92,690.42 |
| Md. | 470,806.25 | 508,163.70 | 492,552.24 |
| Mo. | 861,100.62 | 807,263.78 | 786,988.86 |
| Ohio | 509,573.44 | 2,439,364.17 | 2,360,418.70 |
| Pa. | 232,591.57 | 4,816,175.07 | 4,668,582.25 |
| Tenn. | 196,574.38 | 206,879.70 | 200,504.97 |
| Va. | 27,703.13 | 572,585.25 | 557,809.19 |
| West Va. | 10,674,696.08 | 7,121,651.33 | 6,896,393.88 |
| Wis. | 2,619,399.07 | 2,408,301.57 | 2,342,978.73 |
| | $20,056,680.27 | $24,221,651.36 | $23,475,668.67 |

Ex. 48 shows that the company had certain securities which are not on deposit anywhere in an amount of $556,467.51 but most of these would not be eligible for deposit under any of the state laws (R. 816). It should be stated that no direct testimony was introduced as to the market value of debtor's assets. Debtor made up its schedules from audit reports made by outside accountants who did not testify and whose methods of ascertaining values is not shown. With respect to assets other than securities, no attempt was made to place a valuation thereon in the pro-

ceedings. Thus, while we use the debtor's figures, such as those above, it should be understood that the respondents do not consider themselves bound by such figures as reflecting market or other values. The record would indicate that actual values are, in a number of instances, a great deal lower than indicated in the various schedules in evidence, and it is difficult, if not impossible, to state the true situation as to the degree of debtor's insolvency from the record.

In each state in which it did business, whether the state required a deposit or not, Fidelity was subject to special provisions of law applicable either to insurance corporations, banking corporations, building and loan associations, investment companies or other companies whose business is affected with a public interest. As we have shown, Fidelity, prior to its becoming chartered as a life insurance company, operated under the so-called Annuity Company Law of West Virginia, now repealed. In the states in which it did business it qualified with and was regulated by various state departments, in some states the Insurance Department, in some the Banking Commission and in others the Securities Department (R. 348). In the states which required deposits, as listed above, qualification and regulation was by the various departments as follows:

| State | Department | |
|---|---|---|
| Alabama | Securities Commission | (R. 348) |
| Delaware | Banking Commissioner | (R. 349) |
| Illinois | Secretary of State | (R. 350) |
| Indiana | Auditor prior to 1934, Securities Commission after 1934 | (R. 353) |
| Iowa | Securities Department and Insurance Commissioner | (R. 353) |

| | | |
|---|---|---|
| Kansas | State Corporation Commission by the Securities Commissioner | (R. 354) |
| Kentucky | Division of Securities, Department of Banking and Securities | (R. 355) |
| Maryland | Insurance Department | (R. 356) |
| Missouri | Commissioner of Securities | (R. 357) |
| Ohio | Superintendent of Insurance | (R. 359) |
| Pennsylvania | Formerly Banking Department now Securities Commissioner | (R. 360) |
| Tennessee | Department of Insurance and Banking | (R. 361) |
| Virginia | State Corporation Commission | (R. 363) |
| Wisconsin | Banking Commission (also subject to registration with Securities Department, Ch. 189, Wis. Stats.) | (R. 364) |

With respect to states which did not have deposit laws, the regulatory jurisdiction was as follows:

| State | Department | |
|---|---|---|
| Dist. of Columbia | No regulation | (R. 371) |
| Arkansas | Securities Division, Railroad Commission | (R. 370) |
| Florida | Securities Commission | (R. 371) |
| Georgia | Securities Commission | (R. 371) |
| Louisiana | Securities Commission | (R. 371) |
| Michigan | Department of Insurance | (R. 371) |
| Mississippi | Secretary of State | (R. 371) |

| | | |
|---|---|---|
| Maine | Commissioner of Securities, Department of Commerce | (R. 372) |
| New Jersey | Department of Insurance and Banking | (R. 372) |
| North Carolina | Securities Department | (R. 372) |
| North. Dakota | Securities Department | (R. 372) |
| Oklahoma | Securities Division, State Banking Department | (R. 372) |
| South Dakota | Securities Department | (R. 373) |
| South Carolina | Securities Commission | (R. 373) |

The laws of the various states providing for regulation of such concerns as Fidelity, placed it in varying classifications. In Wisconsin it was subject to all of the provisions of law with respect to the supervision, control and conditions upon which foreign building and loan associations are permitted to do business in that state. Sec. 216.02 Wis. Stats. Registration of its contracts was also compelled under the Wisconsin Securities Law, Ch. 189 Wis. Stats. In Kansas, South Dakota and Mississippi the statutes define a business such as that done by Fidelity as the doing of a building and loan association business, Ch. 17, Art. 10, sec. 17-1047, Corrick's General Statutes of Kansas, Ann., 1935; Tit. 7, Ch. 7.01, South Dakota Code, 1939; Ch. 96, sec. 4300, Hemingway's Ann. Code of Mississippi. In certain other of the states Fidelity was compelled to register its contracts as securities under securities laws which in some instances provided for a deposit. The deposit laws of the various states provide in most cases for a deposit in trust for the benefit and security of contract holders located therein and provide for the liquidation of these funds in the various states when-

ever Fidelity failed to meet its obligations therein. The amount and nature of the deposits made in each of the depositary states are summarized in the opinion of the Circuit Court of Appeals (R. 241-242). These laws will be dealt with in more detail in the briefs of the several respondents.

**8. Fidelity and the S E C**

After the establishment of the Securities and Exchange Commission in 1934 Fidelity's affairs began to receive attention from a new quarter. The Securities Act of 1933 (15 U. S. C. A., sec. 77a to 77aa) required the registration of securities sold in interstate commerce under certain terms and conditions but contained an exemption for "any insurance or endowment policy or annuity contract or optional annuity contract, issued by a corporation subject to the supervision of the insurance commissioner, bank commissioner or any agency or officer performing like functions, of any state or territory of the United States or the District of Columbia." (Sec. (3) (8), Securities Act of 1933 (15 U. S. C. A., sec. 77c (a) (8)).

Fidelity maintained that its contracts were exempt from registration under this clause of the Securities Act (R. 859) although in 1939 it decided to register with the Securities and Exchange Commission (R. 860). However, although a registration statement was prepared, this was never carried out (R. 860-861). As has been shown, the Securities and Exchange Commission made a detailed investigation of Fidelity's business and the business of the two other chief companies selling similar contracts by virtue of sec. 30 of the Public Utilities Holding Company Act of 1935, its report to Congress comprising Ex. 6 in the record herein.

While Fidelity had maintained it was exempt from registration under the Securities Act of 1933, it was subject to the provisions of sec. 17 (15 U. S. C. A., sec. 77q) of that law, relating to fraudulent sale of securities in interstate commerce or by use of the mails.

On December 14, 1938 the Securities and Exchange Commission filed its bill for an injunction against Fidelity in the United States District Court for the Eastern District of Michigan, Southern Division, alleging that Fidelity was engaged in acts and practices which constituted violations of the fraud provisions of the Securities Act of 1933, sec. 17 (a).

On December 22, 1938 Fidelity filed its answer denying generally the allegations of the bill and on the same day consented to the entry of a decree enjoining it from engaging in the acts specified in the complaint. The bill of complaint and other proceedings and judgment therein are found at pp. 197-258 of Ex. 6 herein. This action on the part of the Securities and Exchange Commission received widespread publicity and resulted in contracts being presented for cash surrender to the extent of $9,000,000 (Ex. 21, R. 398). The sale of contracts was completely suspended during and for a period of time after those proceedings (R. 927).

In September of 1938 the peak volume of sales had been reached, contracts having a face amount of $5,600,000 being sold in that month (R. 926). Sales had been stepped up tremendously in the late 1930s. In round figures the total "face amount" sold in 1935 was $16,000,000; in 1936, $25,000,000; in 1937, $40,000,000 and in 1938, $52,000,000 (R. 926). In November of 1938 the volume was $4,700,000 and in December, when the SEC proceedings took place, $3,000,000 and in January and February, 1939 there was no volume

whatever (R. 927). After the SEC suit the highest volume reached was $1,500,000 in August, 1939 (R. 927), and sales were never again built to a point where the company could operate profitably on its then basis of operations (R. 934-935). During 1940 the monthly volume in each of ten months of that year was below $1,000,000 (R. 927).

Carroll D. Evans, who was director of agencies from 1935 to 1940, stated that when he took over the general sales management it was deemed necessary to sell a face amount of 2½ million dollars per month so that the income would meet the outgo (R. 922). Later the objective of $5,000,000 was set as a basis for profitable operations (R. 923). As a result of the SEC proceedings most of the states suspended Fidelity's licenses in 1938 or early in 1939 (R. 393).

On August 22, 1940 the Federal "Investment Company Act of 1940" was approved by the President after its passage by Congress upon the recommendation of the Securities and Exchange Commission after the completion of its report, a part of which comprises Ex. 6. The Investment Company Act became effective January 1, 1941 (insofar as it would affect Fidelity) and set up requirements to be met by companies selling face amount certificates which were utterly impossible for Fidelity to meet (R. 404, 630-631, 866, 946).

Thomas B. Foulk, who held the position of director and general attorney for the company during a period of from seven to nine years, and who had also been vice-president, stated that it was his opinion that under the Investment Company Act of 1940 Fidelity's business was through entirely and that he "just felt that we never could make the grade" (R. 946) and that after reading and

studying the Investment Company Act of 1940 he felt that "Fidelity could not continue and could not live" (R. 946). He said that Fidelity then turned to the idea of becoming a life insurance company as a means of continuing its existence (R. 946).

**9. The various "funds" as shown by Fidelity's books**

As we have shown, Fidelity sold various "series" of contracts from time to time during the years of its existence. In these contracts there were provisions substantially alike which provided that the Association should "create and maintain a reserve fund" for the discharge of its liability upon the particular series of contracts which contained the reserve fund provision. The reserve fund provisions are set forth in paragraph 1 of the various series of contracts (Exs. 1 to 5, inclusive). The earlier contracts, such as the "Special Income Contract" (Ex. 1) did not contain provisions as to the rate at which the reserve was to be improved. The later contracts (Exs. 2, 3, 4 and 5) provided that the reserve was to be created by placing therein a sum which, when improved, at an arbitrary reserve improvement rate, in some cases 4% and in other cases 4½%, would produce a sum sufficient to pay out the contracts in the particular series (R. 776-777).

In paragraph 1 of each of the contracts it was uniformly provided that the reserve fund appertaining thereto which the company contracted to maintain "shall be invested in approved securities and deposited in trust as required by the laws of the state of West Virginia" (Exs. 1 to 5, inclusive). The securities which the company purchased with payments received from contract holders were deposited with the state of West Virginia and with

state authorities elsewhere to comply with the laws of the particular states, but no attempt was made to designate which particular funds the securities came from in forwarding the securities to the various states, nor did the states themselves make any such allocation (Op. Dist. Ct., R. 181; R. 586-587; 634-635; 645-652; 663-667; 760-761). And see Ex. 27 (App. 76).

Prior to December 31, 1938 the cash payments received from the purchasers of various of the contract "series" were commingled in one bank account (Op. Dist. Ct., R. 180). This was changed after the SEC investigation. The securities on deposit with the states were at all times regarded both by the debtor, by the state laws and by the state authorities as securing all obligations to contract holders of the particular state where each deposit was made. The reports made to the states of total liabilities did not show such liabilities by "funds" (Ex. 78, R. 756).

The state deposits were established and the bulk of the securities presently therein was placed therein prior to December, 1938 when the SEC suit was brought. After the SEC suit the sales value was only a fraction of what it had been (*ante*, pp. 24-25), and the suit resulted in contracts being surrendered to the extent of $9,000,000 (*ante*, p. 24), all of which reduced the amount required to be kept on deposit. As shown by Ex. 80 (R. 757), the cash liability to contract holders on December 31, 1937 was over $28,000,000 and reserve liability over $30,000,000, as compared to cash liability of $23,000,000 and reserve liability of $24,000,000 on April 10, 1941. Thus, the deposits were established

without regard to the various "funds" to which the SEC directed attention at the time of its suits.

Except for the state deposits, the contracts were otherwise unsecured. As said in the SEC report (p. 1 of Ex. 6):

> "Irrespective of their designation, these certificates are in essence, simply unsecured obligations of the companies which issue them to pay a specified sum (called the face amount or maturity value or amount), provided the purchaser, promptly, and without any delinquency, makes all of the payments required by these contracts or certificates."

In a footnote in the report (p. 1, Ex. 6) it is then explained that some states require deposits and reference is made to a later discussion of these deposits in the report. See also p. 32 of "Part One" of Report of Securities and Exchange Commission pursuant to Section 30 of The Public Utility Holding Company Act of 1935, where it is said:

> "The certificate holder is not a stockholder of the corporation, which is private in nature, nor does he ordinarily have any interest in or lien upon any of the specific property or assets of the corporation. He assumes, in relation to the company issuing the certificates, the status of a general creditor, not unlike the holder of an unsecured promissory note or debenture of the company."

After the searching inquiry made by the SEC and in order to comply with the injunction decree and the Securities Act of 1933 it was necessary that the situation be fully explained to prospective purchasers of contracts (R. 764-765). Accordingly, in new prospectuses issued thereafter relative to the Series B contracts (p. 11 of Ex. 85, R.

766), a footnote to the balance sheet of the Series B fund stated:

> "The securities deposited with state authorities are subject to the requirements of the states with respect to all the contract funds of Fidelity Investment Association and are not necessarily held for the sole benefit of the holders of these particular contracts. In this connection reference is made to the foreword in this report."

The foreword to the financial statements in the prospectuses stated:

> "State laws with reference to deposits are not uniform. The laws of the states in which deposits against contract liability are required do not provide the mechanics for the segregation of portfolio securities of a particular contract fund against appropriate liabilities in the states of that fund, but merely provide for the deposit of a total amount of securities equal, in some cases, to the total contract liabilities, and in others, to a specified amount. In some states contracts were sold before any law requiring deposits was passed. For such contracts the deposits were made in West Virginia. The corporation recently adopted the policy of depositing portfolio securities belonging to one fund against liabilities of that fund alone, so far as state law permits, but it has been impossible to effect a transfer between various state authorities of securities heretofore deposited so that securities of funds for contracts heretofore issued will be deposited only against liabilities of that fund, although all securities are earmarked and segregated on the Association's books." (Ex. 85, R. 766)

See also Exs. 86 and 87 (R. 766). These statements were placed in the booklets after consultation with representatives of the SEC (R. 1152-1153).

In meeting obligations on maturing contracts, funds and securities were transferred and removed from one fund to another at will to meet the demands on any particular fund (R. 383, 388). The company also pursued a policy of issuing its preferred stock to matured contract holders in lieu of paying them out in cash (R. 390).

**10. Previous efforts to recapitalize**

As early as 1920 an effort was made to declare Fidelity bankrupt and a group was formed to buy out dissatisfied stockholders (R. 418). And we have seen that in 1933 its liabilities were in excess of its assets at market value in the amount of $7,000,000. Prior to 1936 the question of the depletion of the securities portfolio and the reserves had arisen and there was talk about trying to get new capital and how the company might be recapitalized (R. 1136) and reorganized (R. 425). From 1938 and continuously up to the time business was suspended constant efforts were made to get new capital. Arthur B. Koontz, one of the directors who had considerable acquaintance in the financial world, at the request of Fidelity's officers, besought many firms in the investment banking field to examine Fidelity's affairs with a view to refinancing. Negotiations were had with banking groups in Philadelphia (R. 1137), investment bankers in New York (R. 1137-1138) and a life insurance company (R. 1138). The Atlas Corporation, headed by Floyd Odlum, which company and its head were prominent in the investment banking field, worked on the project for some weeks but this too failed

(R. 1140). The Chicago Corporation of Chicago, which had also been asked to refinance Investors' Syndicate (a company engaged in the same type of business as that of Fidelity) went into the matter thoroughly but decided that it did not want to go into it (R. 1141). Extensive negotiations were had with the Morris Plan Bank of New York and with Mr. Arthur Morris, the head of that institution, who was familiar with Fidelity's business, but nothing came of this (R. 1141). Attempts were made to interest the Cleveland brokerage firm of Otis & Company (R. 1141). Some of the leading business men of Wheeling had a meeting and a plan was laid before them, but they evinced no interest in it (R. 1141-1142). Negotiations with Pell & Co. of New York foundered because among other reasons "they wondered whether or not a company operating in this field might be successful in the future" (R. 1139). In January, 1939, several weeks after the Securities and Exchange Commission's injunction suit in Detroit, efforts were made to place the company in a federal equity receivership. This litigation comprises the cases of *McCammon v. Fidelity Investment Association*, 26 F. Supp. 117 (N. D. W. Va., 1939) and *Hutchinson v. Fidelity Investment Association*, 106 F. (2d) 431 (CCA 4th, 1939).

In August of 1940 Allen G. Messick of Chicago was brought into the company at the instance of F. P. Pulfer (R. 525). Messick was an old school friend of Pulfer, and Pulfer had discussed the plight of Fidelity with him at a luncheon meeting in Chicago (R. 526). Messick interested one Rosset in Fidelity and Rosset and Messick entered into a contract with Fidelity whereby they were, on certain terms and conditions, to provide the sum of $500,000 so that Fidelity might continue its business (R. 1142). In

connection with this contract a voting trust of Fidelity's stock was created with John Marshall, Sr., as voting trustee. Although Marshall became voting trustee of Fidelity's stock, the money which Messick was to procure was not forthcoming and it was never produced. It is not quite clear why the plan fell through (R. 1143). Mr. Pulfer stated it was because it was found the money was to come from a Mr. Green in Chicago, who did not bear a good reputation and was later indicted by reason of some stock transactions (R. 526). Rosset brought suit against Messick and Fidelity in Chicago, charging breach of contract (R. 1143). Messick was elected to the Board of Directors in August, 1940, and became chairman of the Board in September, 1940, at a salary of $1,000 per month (R. 540). He received the salary for three months but it was cut off at the urgent request of Auditor Sims (R. 445-446). Auditor Sims did not know whether Messick had a real plan or whether it was a pretended plan, "a device to get inside" (R. 446). He felt that Messick "did not come to fetch the money, but he came to get the money" (R. 476).

**11. The institution of the West Virginia state court proceedings**

On March 25, 1941 Auditor Sims of West Virginia had written a letter (Ex. 94) to Arthur B. Koontz, one of the counsel for the company, advising that he contemplated instituting proceedings in the Circuit Court for Kanawha County, West Virginia (R. 1127). Mr. Sims had made very strong suggestions to the company earlier in the year that court proceedings would be necessary with respect to Fidelity's affairs (R. 1183). The situation was discussed with the officers of the company and with Mr. John Marshall, Sr., its chief counsel, and with Mr. Foulk, its gen-

eral attorney (R. 1183-1184). The company had had discussions with representatives of the SEC as to the type of court proceedings which would be best suited to the situation (R. 1184-1185). Both state and federal proceedings were discussed with varying opinions being expressed, and several members of the SEC staff advised the company that they did not wish to be put in the position of advising the company what the forum was to be (R. 1186). The possibility of federal reorganization proceedings was explored (R. 1187). It was finally determined that the best plan would be to go along with the West Virginia state court proceedings instituted by Auditor Sims (R. 1187-1188). On April 4, 1941 Auditor Sims ordered Fidelity to "freeze" its business, and thereafter Auditor Sims, acting through the Attorney General of West Virginia, instituted the proceedings in the Circuit Court for Kanawha County. The bill of complaint in that action comprises Ex. 21 (R. 398). On April 7, 1941 Fidelity's Board of Directors, upon motion of John Marshall, Sr., passed an unanimous resolution authorizing the law firm of Koontz and Koontz to represent it in the suit instituted in West Virginia by Auditor Sims (R. 1156-1157). Fidelity entered its appearance in the West Virginia proceedings but interposed no answer or objection thereto (R. 1192). Auditor Sims sent a copy of the bill of complaint in the West Virginia proceedings (Ex. 21, R. 308) to the various state authorities. Auditor Sims had also telegraphed the various state authorities asking that they institute proceedings to protect the assets in their respective states (R. 508).

In the West Virginia suit two receivers were appointed, being Ross B. Thomas and H. Isaiah Smith, and these receivers took certain assets into their hands, consisting of

cash in banks and undeposited securities of the value of some $500,000 (R. 819). The West Virginia state court receivers did not take over the assets on deposit with the State of West Virginia, which still remain with the State of West Virginia in the custody of the State Treasurer subject to the control of the Auditor (R. 819). The receiver Ross B. Thomas was an associate of the firm of Koontz and Koontz, and H. Isaiah Smith was formerly Budget Director of the State of West Virginia. After the commencement of the federal proceedings the federal trustee appointed H. Isaiah Smith to act in a managerial capacity in charge of the affairs of Fidelity (R. 477).

**12. The institution of the other state court proceedings**

Upon the company's suspending payment of its obligations and upon the institution of the West Virginia proceedings other state authorities took action.

**Wisconsin**

On April 14, 1941 proceedings were instituted by the Banking Commission of Wisconsin, under statutes providing for liquidation of foreign building and loan associations in that state. Notice of these proceedings was duly given to the officers of Fidelity and Fidelity was represented by its Wisconsin attorney. Fidelity did not oppose the proceedings in Wisconsin. Title to the Wisconsin assets of Fidelity, including the securities deposited with the State Treasurer in the amount of some $2,600,000, was vested in the Banking Commission of Wisconsin by order of the Circuit Court for Dane County, Wisconsin. The Banking Commission of Wisconsin proceeded to administer the affairs of Fidelity and prior to the institution of the Chapter X proceedings had

received proofs of claim from substantially all of the Wisconsin contract holders. These number about 12,000, of which approximately 6000 are "active." On May 27, 1941 securities comprising the approximate value of $1,259,000 of the Wisconsin deposit were liquidated and sold by the Banking Commission of Wisconsin, and these funds are presently held for distribution to Wisconsin contract holders. Ex. 120 (R. 3803 (original)) comprises a certified copy of the proceedings in Wisconsin. The Banking Commission of Wisconsin, through the Attorney General of Wisconsin, intervened in these proceedings and filed its answer controverting the allegations of the debtor's petition and is one of the respondents herein.

**Iowa**

The Iowa proceedings were instituted in the District Court in and for Polk County, Iowa, whereby Charles R. Fischer, Commissioner of Insurance of the State of Iowa, who had jurisdiction over Fidelity there, was appointed receiver. All of the securities comprising the Iowa deposit have been sold and the funds are presently held for distribution to contract holders. The proceedings in the Iowa state court are found in Ex. 121 (R. 3803 (original)) herein. The Commissioner of Insurance of Iowa intervened in these proceedings and filed an answer controverting the allegations of the debtor's petition and is one of the respondents herein.

**Ohio**

In Ohio, shortly after the West Virginia proceedings, a receivership action was instituted in the Common Pleas Court of Franklin County by John A. Lloyd, Superintend-

ent of Insurance of Ohio, through the office of the Attorney General of Ohio, for the purpose of taking possession of and protecting some $10,000 in undeposited assets in Ohio (R. 817).

The securities comprising the Ohio deposit were on deposit with the Treasurer of State of Ohio. This deposit is subject to liquidation under specific Ohio laws with reference to liquidation of deposits of insurance companies and bond investment companies (R. 817). The Treasurer of State of Ohio filed a motion to intervene in these proceedings, through the Attorney General of Ohio, which was granted, and filed an answer controverting the allegations of debtor's petition herein. This answer was withdrawn upon the entry of an order herein by the District Court on October 29, 1941, providing that the securities on deposit with the Treasurer of State of Ohio should remain there until such time as a reorganization plan might be adopted and approved in these proceedings, but without prejudice to Ohio's status as an intervener herein.

**Illinois**

In Illinois the Secretary of State with whom the Illinois deposit was made (although actual custody was with the State Treasurer) instituted a proceeding in the Circuit Court of Sangamon County, Illinois, for the appointment of a receiver for the preservation and maintenance of the securities on deposit in Illinois. This was in accordance with sec. 6 (a) of the Illinois Securities Act as amended providing for the liquidation of the securities on deposit in Illinois in the event of insolvency. These matters are set forth in the petition for leave to intervene filed in these proceedings by the Attorney General of the State of Illinois.

The Attorney General of Illinois filed an answer controverting debtor's petition on behalf of the State Treasurer and Secretary of State of Illinois. This answer was withdrawn upon the entry of an order herein by the District Court on October 4, 1941 providing that the securities on deposit in Illinois should remain there until such time as a reorganization plan might be adopted and approved in these proceedings.

**Tennessee**

In Tennessee certain contract holders on April 21, 1941 filed a bill in the Chancery Court in Davidson County, Tennessee, for the benefit of themselves and all other holders of contracts sold in Tennessee to enforce a lien on the Tennessee deposit which was made with the State Treasurer of Tennessee. These Tennessee contract holders intervened in these proceedings and filed an answer controverting the allegations of debtor's petition and are respondents herein.

**Missouri**

In Missouri a receiver was appointed in a suit commenced by the Attorney General of Missouri at the request of the Commissioner of Securities in the Circuit Court of Cole County. The Missouri receiver filed an answer controverting the allegations of debtor's petition herein and is one of the respondents herein.

**Maryland**

In the State of Maryland the affairs of Fidelity and the deposit are under the jurisdiction of the Insurance Commissioner of Maryland, who appeared in these pro-

ceedings and filed a motion to vacate certain orders of the District Court ordering the securities on deposit in Maryland to be turned over to the federal trustee. The Insurance Commissioner of Maryland is one of the respondents herein.

**Kansas**

The Securities Commissioner of the State of Kansas also entered an appearance in the proceedings through counsel.

No state holding a deposit complied with the turn-over portion of the orders of the District Court entered June 6 and June 10, 1941. The turn-over portion of such orders was rescinded by order of the District Court dated August 9, 1941. Since the filing of the federal petition the various state court proceedings have been held in abeyance except that under the order of the Circuit Court of Appeals for a stay of mandate the various state authorities have been permitted to send out proofs of claim to their contract holders.

More detailed reference to the proceedings which have transpired in the various states where Fidelity maintained a deposit or was otherwise regulated will be found in the briefs of the several respondents herein.

**13. The institution of the federal proceedings**

The decision to file the petition under Chapter X seems to coincide with the appearance on the scene of James R. Fleming, an attorney of Fort Wayne, Indiana, who was brought into the picture by Allen G. Messick, the most recent chairman of the Board, who was a close friend of Mr. Fleming (R. 1158-1159). John Marshall, Sr., who

prior to the appearance of Messick seemed to be the dominant figure in the company, appears to have come to rely upon Messick and Fleming. After the institution of the West Virginia proceedings Mr. Koontz discussed matters affecting the company with Mr. Marshall, and while Mr. Marshall did not express any dissatisfaction whatever with the course of the West Virginia proceedings, he told Mr. Koontz there were some people who thought the proceedings should be in federal court, and it finally developed that it was Fleming who had advised him in this regard (R. 1158-1159). Mr. Fleming conferred with Mr. Koontz and stated that he represented some interests in Fort Wayne, Indiana who might be interested in putting money into the company (R. 1160). He asked Mr. Koontz to prepare a plan of reorganization so he could indicate to his associates that there was some chance of rehabilitating the company, but Mr. Koontz stated that he could not do this in such a short time (R. 1161). Exhibit 115 (R. 3763 (original)), a letter dated November 25, 1940 addressed by John Marshall, Sr. to Arthur Koontz, would indicate that one of the reasons Mr. Marshall favored Mr. Messick was that he thought Messick could get money for the company and also that Messick would provide a place in the company for his son, John Marshall, Jr.

The filing of the petition under Chapter X was authorized by a directors' meeting held in Pittsburgh, Pennsylvania on June 3, 1941. There were only six directors present and seven were required for a quorum, so Mr. Fleming was elected as a member of the Board to make a quorum and resigned at the end of the meeting (R. 688-689). A. L. King, one of the directors, refused to vote for the filing of the federal petition because he felt that the state court receivers

had not had time to submit a plan in state court (R. 689-690). The District Court in its opinion held that this was not a legal meeting (R. 189-190). The petition under Chapter X was, however, filed on June 6, 1941.

On September 17, 1941, during the course of the hearing on the controversial answers to the debtor's petition, another meeting of the Board of Directors was held for the purpose of ratifying the filing of the petition (Ex. 92, R. 2205 (original)). Still later during the course of the hearing and on October 3, 1941 a stockholders' and directors' meeting was held to again ratify the filing of the petition (Exs. 98, 99, R. 959).

On June 7, 1941 the District Court entered an order authorizing the federal trustee to employ Mr. Fleming and Mr. Messick "for special services." This order was revoked by a later order dated August 1, 1941. Mr. Fleming and Mr. Messick conferred with the Banking Commission of Wisconsin on June 12 and stated that they had been authorized by the federal trustee to contact the various states to ascertain their attitude as to the deposits (R. 1054). Mr. Fleming stated to a meeting of state officials in Chicago on June 13 that he and Mr. Messick had been retained by the trustee to work out a reorganization plan (R. 848-849). Mr. Fleming represented the debtor at the commencement of the hearings on the controversial answers to the petition but withdrew during the course of the trial and was replaced by Mr. John Ray on September 17, 1941 (R. 662). There has been no indication whatever during the course of these proceedings that Mr. Fleming's group or anyone else would furnish any new capital for the debtor.

**14. The obtaining of the life insurance charter and licenses**

We have previously related that on December 31, 1940 the debtor amended its charter so as to become a life insurance company. Its sole charter purpose after that date was as follows:

> "To issue insurance upon the lives of persons and every insurance appertaining thereto and connected therewith, and to grant, purchase and dispose of annuities."

The change of charter was approved by the Insurance Commissioner and by the Secretary of State of West Virginia. The Insurance Commissioner also issued to the company a license to do business as a life insurance company on December 31, 1940, which expired March 31, 1941. The company applied for a renewal of such license and the Insurance Commissioner renewed it on April 1, 1941, to expire on March 31, 1942. All this is set forth in Ex. 24 (R. 437), the certificate of the Insurance Commissioner of West Virginia, found at page 76-79 of the Appendix to this brief. During the argument on the appeal in the Circuit Court of Appeals the debtor disputed the fact that the license as an insurance company was renewed on April 1, 1941, and at the request of the court the debtor and the respondents signed a stipulation (printed below) at the bar of the court to the effect that the debtor had applied for a renewal of the license shortly before April 1, 1941 and that this license was issued, but that on June 6, 1941 the license was not in possession of the company but was in possession of the Auditor of the State of West Virginia, and that prior to June 6, 1941 the check sent in payment for this license had been returned, and that the company was not operat-

ing under said license at the time the federal petition for reorganization was filed. Since Auditor Sims issued his "freeze" order to the company on April 4, 1941 and receivers were appointed on April 10, 1941, we may assume that the fees for the license for the year 1941-1942 were returned for the reason that the company was in effect out of business shortly after the issuance of the renewal license. The fees for the salesmen's licenses were also refunded, although the record does not show when (R. 462).

All through the trial in the District Court the debtor contended that it at no time issued any life insurance contracts under its charter and license as a life insurance company, and the District Court so found, and its opinion that the debtor was not a life insurance company was predicated upon such facts. However, it was subsequently discovered that the debtor had in fact issued many thousands of life insurance contracts by virtue of certain insurance "riders" under which Fidelity had assumed the life insurance provided for in the Series B contracts, which it had issued. These facts were brought to the attention of the Circuit Court of Appeals by a motion made by the West Virginia respondents, and at the request of that court the debtor, the Securities and Exchange Commission and these respondents entered into the following stipulation (R. 237-238):

> "Counsel admit at the Bar of the Court that the license applied for shortly prior to April 1, 1941, was issued but was in possession of the Auditor of West Virginia on June 6, 1941, and that the check sent in payment therefor was returned without being cashed prior to June 6, 1941, and that the Company was not operating under said license at the time of the filing of these proceedings on June 6, 1941; and that the total

number of riders sent out on December 31, 1940, which were signed by contract holders and returned to the Company, was 9,802; and that the total number of Series B contracts with insurance clause on December 31, 1940, was 14,626.

(Signatures omitted)"

"Approved April 20, 1942. John J. Parker, Senior Circuit Judge."

The "riders" which were referred to in the stipulation and which were executed by Fidelity and 9,802 persons were in form as follows:

"FIDELITY ASSURANCE ASSOCIATION

"ASSUMPTION OF RISK AND RIDER ATTACHED TO AND A PART OF INCOME RESERVE CONTRACT SERIES 'B' NUMBER

"The Association, having so amended its charter as to authorize it to issue insurance upon the lives of persons and every insurance appertaining thereto and to grant and dispose of annuities, and to change its name to Fidelity Assurance Association, in consideration of the monthly payments, provided for in the above numbered contract hereby assumes and does itself hereby agree to fulfill and pay all the risks and obligations of the insurance policy and the insurance company mentioned in Section C of said contract.

"It is hereby agreed between the Association and the contract holder that this insurance agreement shall become and be a part of said contract and the original shall be attached thereto.

"Executed in duplicate at Wheeling, West Virginia this 31st day of December, 1940.

FIDELITY ASSURANCE ASSOCIATION

(Signed) F. S. Risley
President

(Signed) Glenn W. Stephens
Contract Owner.

34S-11190 L
GLENN W. STEPHENS,
1st CENTRAL BLDG.,
MADISON, WIS."

When these "riders" were sent to such persons for execution a letter from Fidelity accompanied them which read as follows:

"December 31, 1940

"Dear Contract-owner:

"It is with pleasure and confidence that we direct your attention to the change in our name and the widening of the scope of our business to that of issuing insurance on the lives of persons. In the future, the company will be known as Fidelity Assurance Association and will offer a complete line of life insurance policies of all types and classes, including life annuities.

"These changes enable us, as a qualified legal reserve life insurance company to assume the risks and obligations provided in Section 6 of your contract. As you know, this Section makes available to you insurance covering all monthly payments not yet made in event of your death. Such insurance protection has, in the past, been procured from a legal reserve life insurance company, but was subject to cancellation upon due notice, at any time. With the making of your

regular monthly payments and the Association assuming the insurance, this condition has been eliminated.

"By resolution of the Board of Directors and by the rider enclosed in duplicate, the Association assumes and itself agrees to fulfill and pay the risk and obligations of the insurance policy and of the insurance company mentioned in Section 6 of your contract. The original of the rider is to be signed and attached to your Income Reserve Contract, Series B and the other (the blue one) signed and returned to the Association in the enclosed envelope." (See Ex. 100, R. 2863 (original))

The issuance of these riders had been formally approved at a special meeting of directors held December 31, 1940, whereby it was resolved that in view of the fact that the company was qualified and admitted to transact a life insurance business, it did thereby assume and agree to fulfill and pay all of the risks and obligations of the insurance policy and the insurance company mentioned in Sec. 6 of the Series B contracts. At this meeting life insurance policy forms were adopted, a medical director was selected and conditions under which the company would issue life insurance policies of various denominations were formally set forth (p. 156 of Ex. 100, R. 2863 (original)).

In addition to the official chartering and licensing of Fidelity as a life insurance company by West Virginia, the state issued licenses to twenty life insurance salesmen upon application of the company, and approved a number of life insurance policies to be issued (Ex. 24, R. 437, App. 76-79).

At the time of the issuance of the life insurance charter and license Auditor Sims and Fidelity had made a "gentle-

men's agreement" to the effect that the company would not sell any insurance policies until he gave permission (R. 406). With respect to this agreement Auditor Sims testified, "Those licenses were actually issued but the company was told not to sell anything until they got right with our office. I did that for the purpose of—licensed them for the purpose of receiving installment payments on the outstanding contracts." (R. 438)

However, in addition to continuing to receive payments on its outstanding annuity contracts by virtue of its life insurance company charter and license, the company in fact also issued life insurance policies and assumed life insurance risks.

Upon the charter change being authorized Fidelity notified the various state authorities of this fact. It addressed a letter to the Banking Commission of Wisconsin under date of December 21, 1940 as follows:

> "At a very recent meeting of the Board of Directors of the Fidelity Investment Association, it was unanimously decided that this company should broaden its field of activities by entering the life insurance business. The amendments to our charter, enabling us to write life contracts, were unanimously approved by the stockholders at their meeting. Under these circumstances we will discontinue the sale of contracts under our registration with your department and respectfully request that such registration be terminated at December 31 without prejudice." (Ex. 93, R. 2444 (original))

**15. The plan and purpose behind the new charter**

The federal "Investment Company Act of 1940" was to become effective on January 1, 1941, and it became obvious to the officers of the company that it could not comply with the requirements of this law so as to be able to continue in the business of selling face amount certificates (R. 403-404, 630, 701, 946). The idea of converting Fidelity's business into that of a life insurance company had been discussed by officers and directors of the company "about five or six months prior to the actual change" (R. 879-880). It had been discussed with John Marshall, who at that time was general counsel, with Mr. Foulk, the general attorney, the firm of Koontz & Koontz and others (R. 880). According to Fred Risley, the most recent president of the company, the officers knew at the time of the passage of the Investment Company Act of 1940 (August, 1940) that something would have to be done to change the form of Fidelity's business (R. 880-881). At first the thought was to try to develop a new form of annuity contract but that idea was abandoned and the idea of forming a life insurance company was adopted (R. 881). The company engaged an attorney in Chicago, who was experienced in the life insurance field, to assist in preparing the life insurance policies, rate book and "all the paraphernalia that goes with a life insurance company" (R. 879). The officers of the company considered that its business was already very similar to that of a life insurance company (R. 529).

Since 1934 the company had been selling the Series B contracts exclusively and 75% of the contracts sold had the life insurance feature (R. 681). The authorities of the states of Ohio, Kentucky and Alabama had ruled that the Series B contracts with insurance could not be sold in those

states unless the company was qualified as a life insurance company (R. 315). For this reason the Series D contracts were issued and sold in these particular states (R. 315). A substantial amount of the holders of the older contract series had converted them into Series B with insurance (R. 335-336).

It seems to be conceded by the proponents of the petition and others who testified in these proceedings, that if Fidelity should ever do business again it must be as a life insurance company (Ex. 29, R. 489; R. 416, 451, 457, 631, 670, 932-933, 944-945, 1086-1087, 1131, 1214-1215). In connection with Fidelity's conversion into a life insurance company it was necessary that its outstanding liabilities should be reduced so that it might go ahead as a life insurance company (R. 1157). Many plans were proposed. As expressed by Mr. Foulk, the company's general attorney, "as an insurance company, if we could work into that, I felt that there was a possibility of placating our people and having them comfortably go along" (R. 944-945). In order to accomplish this purpose, Fidelity, through Allen Messick, retained Raymond Latta, an experienced life insurance actuary, in February, 1941, to work out plans to have the company's contract holders voluntarily reduce their claims (R. 1125-1126). Fidelity was going "to try to put our men out and ask the contract holders to cut down their claims or contracts and still go on through reorganization outside any court" (R. 1185). Latta, in collaboration with others in the company, prepared various plans with a view to applying the contract holders' equities "toward the life insurance annuity contract" upon a voluntary basis (R. 1069). Among other plans prepared were a so-called "graduated reorganization plan" (Ex. 111, R. 1075) and a so-

called "uniform reorganization plan" (Ex. 112, R. 1075). All plans so prepared involved a scaling down of contract holders' interests. Mr. Latta was retained by the federal trustee until September 15, 1941 (R. 1056), but no plan for adoption in the federal proceedings has ever been submitted.

The purpose of becoming a life insurance company is made clear by John Marshall's letter of November 25, 1940, to Arthur Koontz (Ex. 115, R. 3763 (original)). He stated:

> "I think, too, that the idea of changing to an insurance company is an excellent one. Particularly in recent years that has really been our business—selling a contract with insurance features. If we become as successful as we once were in the sale of contracts, with a reduced guarantee and more participation in the strictly insurance features, we ought to make money again. Of course, one of the distinct features is that we leave our ally, the Investor's Syndicate, and join a strong group where we will be one of many. Finally, we get away from the S. E. C., which I think will always be an annoyance even if that body is reformed."

We should point out here that under the Investment Company Act of 1940, 15 U. S. C. A., sec. 80a, an insurance company is not an "investment company" so as to be subject thereto. Sec. 3 (c) Investment Company Act of 1940, 15 U. S. C. A., sec. 80a-3 (c). In the Investment Company Act of 1940 an insurance company is defined as follows:

> "'Insurance company' means a company which is organized as an insurance company, whose primary and predominant business activity is the writing of insurance or the reinsuring of risks underwritten by insurance companies, and which is subject to supervision by the Insurance Commissioner or a similar offi-

cial or agency of a state * * *" Sec. 2 (a) (17) Investment Company Act of 1940, 15 U. S. C. A., sec. 80a-2 (a) (17).

Fidelity's whole point and purpose in effecting the charter change was to come within this language so as to be an insurance company subject to state regulation only.

As expressed by A. L. King, who had been a director, assistant treasurer, vice-president, comptroller and secretary for many years, "Well, with the amended S. E. C. statute—whatever you call it—coming into force on January 1, we knew previous to that time that we could not continue to sell our contracts as Fidelity Assurance—Investment Association after that date. We felt, in view of the fact that we had been selling an insured contract for a period of four or five years which appealed to the public, that we could convert our association into an insurance company and broaden our field of activity to include other types of insurance and make a specialty of the sale of an insured contract that would pass the requirements of the State Insurance Commissioner" (R. 701).

John Marshall stated that Mr. Latta was well qualified to assist the company because "he had been in reorganization matters and was acquainted with the same type of business that we were in and in the insurance business that we would go into" (R. 1005).

Howard E. Reed, "vice-president in charge of bank and public relations" and a director of Fidelity, stated that many life insurance companies sold annuity contracts and referred specifically to the Franklin Life Insurance Company as doing "a general life insurance business and they sell an annuity contract" (R. 736). Henry M. Steussy, formerly Wisconsin sales manager for Fidelity, who had later

become vice-president of the Franklin Life Insurance Company, stated that that company was selling a face amount certificate which "qualifies as an insurance policy" and "was reconstructed just as the Fidelity contract would have to be reconstructed if the Fidelity Assurance Association was going to operate as an insurance corporation" (R. 1016, 1024). Fidelity intended to do the same thing.

Fred Risley, Fidelity's president, agreed that "everything was attempted that could lawfully and reasonably be attempted to begin the company's operation as an insurance company" (R. 885).

**C. Facts particularly affecting the interests of Wisconsin contract holders and the Banking Commission of Wisconsin.**

Fidelity was licensed to sell its contracts in Wisconsin and sold the same there from June 26, 1930 to the close of 1940. It was licensed annually by the Banking Commission of Wisconsin under the statutes of Wisconsin appertaining to foreign building and loan associations. Sec. 216.01, Wis. Stats., provides that corporations soliciting payments in a lump sum or periodically or on the installment plan must, in order to transact business in the state, comply with all of the provisions of Chapter 215, Wis. Stats., required of foreign building and loan associations authorized to do business in Wisconsin. Fidelity's business came within this description and thus it was licensed under Chapter 215 relating to building and loan associations. Sec. 215.38 of Chapter 215 provided that no foreign building and loan association should transact business in Wisconsin unless it should

> "* * * have and keep on deposit with the state treasurer, in trust for the benefit and security of all its members in this state, five hundred thousand dollars to be held in trust as aforesaid until all shares of such association held by residents of this state shall be fully redeemed and paid off and until its contracts and obligations to persons and members residing in this state shall have been fully performed and discharged. * * *"

It was also provided that the securities comprising the deposit should first be approved by the Banking Commission under the same rules and regulations as govern the approval of securities of trust company banks. It was further provided that whenever the Banking Commission should find that the liability on contracts held by persons residing in Wisconsin exceeded ninety per cent of the deposit, the Banking Commission should require the deposit of additional securities. Its contracts were also subject to the Securities Law of Wisconsin, Chapter 189, Wis. Stats. The laws of Wisconsin, insofar as pertinent here, to which Fidelity was subject are printed at pages 1 to 20 of the Appendix hereto.

Fidelity deposited securities with the State Treasurer of Wisconsin under these provisions of law. As of April 10, 1941, according to Fidelity's figures, the "net reserve liability" on contracts held by Wisconsin residents was $2,408,301.57, while the market value of the securities on deposit there as of June 6, 1941 was $2,619,399.07 (Ex. 48, R. 1116 (original)). About half of the securities comprising the Wisconsin deposit were liquidated and sold in the proceedings had there prior to the filing of the petition for reorganization herein, which securities are included in the latter figure.

The Wisconsin sales were directed from Fidelity's Milwaukee office which was in charge of Mr. Henry Steussy, who testified in these proceedings. A sales force of 225 men was built up in Wisconsin and a volume of over one million dollars in face amount per month was reached (R. 1011). Wisconsin was one of the five states in which the company had its largest volume of sales (Ex. 48, R. 1116 (original)). The total number of contracts outstanding in Wisconsin is approximately 12,000, of which approximately 6,000 are "active" (Ex. 34, R. 515).

In the sale of the contracts in Wisconsin the law of Wisconsin was emphasized (R. 1048). In the sales material prepared at the home office and used in Wisconsin the greatest stress was laid upon the fact that the company was supervised by the Banking Commission of Wisconsin and had securities on deposit with the State Treasurer. Ex. 106 (R. 1034), a handsome brochure used in making sales in Wisconsin, containing pictures of the state capitol of Wisconsin and quoting "the exacting law of Wisconsin." illustrates the method in which sales were made on the basis of the Wisconsin law. A great number of the Wisconsin contract-holders have advised the Banking Commission of Wisconsin that they purchased their contracts by reason of the representations made to them as to the Wisconsin law, and that since the money was placed on deposit for their protection they feel it should be paid over to them. The Wisconsin contract holders are not in favor of the federal proceedings. See Ex. 114, R. 3546 (original), printed at pages 27-36 of the Appendix hereto.

Upon the company's ceasing payment of its obligations in Wisconsin, and on April 14, 1941, three days after the institution of the West Virginia state court proceedings by

the Auditor of West Virginia, the Banking Commission of Wisconsin took possession of the Wisconsin business and assets of Fidelity under the statutory proceeding provided by the laws of Wisconsin for the liquidation of building and loan associations, particularly sec. 215.33, Wis. Stats. (App. 8). These proceedings were instituted in the Circuit Court for Dane County, Wisconsin. Due notice to Fidelity and its officers, as provided by statutes, was given and Fidelity entered its appearance therein by counsel, but interposed no objection to the proceedings. A certified copy of the Wisconsin proceedings comprises Ex. 120 (R. 3803 (original)) of the record herein. The Attorney General of Wisconsin represents the Banking Commission in the Wisconsin proceedings under provisions of Wisconsin law providing therefor. By operation of law (sec. 215.33 (8), Wis. Stats., App. 15) and as provided by the order of April 14, 1941, of the Circuit Court for Dane County (App. 22-25), title to and possession of all of Fidelity's assets located in Wisconsin were vested in the Banking Commission of Wisconsin "to be administered by the Banking Commission of Wisconsin under the supervision and control of the Circuit Court for Dane County, Wisconsin, for the benefit and security of contract, bond or certificate holders, residents of this state * * *" (App. 22). The filing of the notice of taking possession also operated under sec. 215.33 (8), Wis. Stats., as a bar to any action against Fidelity or its assets in Wisconsin, and this was also provided for by the court order. Actual custody of the deposited securities remained with the State Treasurer of Wisconsin pending the proceedings (App. 23). Under date of May 16, 1941 the Circuit Court for Dane County ordered that the Banking Commission should proceed to give notice for the filing of claims

Substantially all of the Wisconsin contract holders duly filed their claims with the Banking Commission of Wisconsin (Ex. 114, R. 3546 (original)) prior to the filing of the federal petition. The actual contracts were filed with these claims.

On May 16, 1941 the Banking Commission having determined that certain of the securities comprising the Wisconsin deposit should be sold, the court ordered that securities should be sold up to the amount of $1,500,000.

On May 27, 1941 the Banking Commission sold certain of the Wisconsin deposited securities realizing the sum of $1,259,244.04 therefor. This sale was approved by the court on May 29, 1941, and the funds realized ordered to be deposited in banks selected by the Banking Commission (Ex. 120, R. 3803 (original)). This was in accordance with sec. 215.33 (6), Wis. Stats., providing for the deposit of funds arising out of the liquidation of delinquent building and loan associations and providing that such funds constitute preferred deposits. These funds are presently held ready for distribution to Wisconsin contract holders. A schedule of the securities sold in Wisconsin with the par value and price realized thereon is contained in Ex. 120, (R. 3803 (original)) and is printed at page 26 of the Appendix hereto.

On June 9, 1941 the Banking Commission was notified by telegram, signed by Central Trust Company, that the District Court for the Southern District of West Virginia had on June 6 approved a petition for reorganization of Fidelity, and that all persons holding property of the debtor should turn the same over to Central Trust Company. Subsequently, copies of the District Court's *ex parte* orders of June 6 and June 10 ordering that the Banking Commission

should turn over any assets in its possession to Central Trust Company and enjoining continuance of the state proceedings were mailed to the Banking Commission. The Banking Commission of Wisconsin did not comply with these purported orders insofar as they provided for a turnover of the deposited assets to the federal trustee. It has voluntarily held its proceedings in *status quo* pending the determination of the jurisdiction of the District Court for the Southern District of West Virginia.

**D. Facts particularly affecting the interests of Iowa contract holders and the Commissioner of Insurance of Iowa**

Fidelity Assurance Association, formerly known as Fidelity Investment Association, made application under the latter name to the state of Iowa through its Executive Council pursuant to the provisions of Chapter 392, 1927 Code of Iowa, for authority to sell its contracts in the state and said application was granted and a certificate of authority issued out of the office of Auditor of State on or about January 7, 1929. At the time of the issuance of certificate of authority the debtor corporation deposited with the Auditor of State of Iowa approved securities in the sum of $25,000 pursuant to the provisions of Chapter 392, 1927 Code of Iowa, said deposit being made for the specific purpose of guaranteeing to Iowa contract purchasers faithful performance of debtor corporation's obligations. Thereafter debtor corporation deposited additional securities in an amount at all times equal to its liabilities in this state in accordance with Iowa law. (See App. 37-40 for Chapter 392).

Thereafter on March 28, 1930 debtor corporation registered its investment contracts as an issuer-dealer pursuant to the provisions of Chapter 393, 1927 Code of Iowa (now Chapter 393.1, App. 41-43) and also filed its written consent without power of revocation that suits and actions might be commenced and maintained in the courts of this state by service of process or pleading authorized by law on the Secretary of the State of Iowa, as required by law. After 1936 debtor corporation's license and certificate of authority were not renewed and it was thus prohibited from carrying on its business as an issuer-dealer. In order that said debtor coporation might continue to collect and disburse on its outstanding contracts, although prohibited from selling new contracts, it filed application under date of December 17, 1937 with the Secretary of the State of Iowa for a permit to do business as a foreign corporation, pursuant to the terms of Chapter 386, 1935 Code of Iowa (App. 50-52), and with said application filed a resolution adopted by its Board of Directors designating a resident agent on whom service of original notice of civil suits might be served in the manner provided for in Section 3421, Chapter 386, 1935 Code of Iowa.

Debtor's "net cash liability" to Iowa contract holders is approximately $35,000 and debtor has deposited in Iowa bearer securities of the approximate par value of $42,000. These securities were deposited by the debtor in trust for the express purpose of guaranteeing 100% faithful performance on the part of debtor corporation, pursuant to the provisions of Chapter 392 of the Code of Iowa.

On April 11, 1941 debtor corporation was adjudged and decreed to be insolvent in the state of West Virginia. The debtor corporation had for some time occupied a pre-

carious position in the state of Iowa, and upon the receipt of this information Charles R. Fischer, Commissioner of Insurance, through the Attorney General for the state of Iowa, commenced an action in the District Court in and for Polk County, Iowa to wind up the affairs of debtor corporation pursuant to the provisions of Chapters 392 and 393.1, Code of Iowa 1939. An order was entered on April 16, 1941 by the District Court in and for Polk County, Iowa, prohibiting any business transactions on the part of said debtor corporation.

Shortly thereafter one Guy R. Shaw, an Iowa resident contract holder, filed his petition in the nature of a creditor's bill, stating his interest and the interests of others similarly situated, alleging the deposit of securities in trust with the state for benefit of contract holders and the insolvency of debtor corporation and praying that an order issue appointing Charles R. Fischer temporary receiver. On April 23, 1941 Charles R. Fischer answered and cross-petitioned to Guy R. Shaw's petition, admitting that title to securities vested in the state of Iowa for use and benefit of contract holders on dates of their deposit and praying that he be appointed temporary receiver. On April 24, 1941 an order issued appointing Charles R. Fischer temporary receiver and prescribing the notice to be given to the Iowa resident agent, the receivers in West Virginia and the officers of debtor corporation, and said notice was duly given setting the day of May 19, 1941 as the date for hearing upon the appointment of Charles R. Fischer as permanent receiver of debtor corporation.

On April 24, 1941, on motion of John M. Rankin, Attorney General for the State of Iowa, an order was entered consolidating the original cause commenced by the Attor-

ney General with the cause commenced by Guy R. Shaw, a contract holder.

On May 1, 1941, one E. G. Pullen, a resident contract holder in debtor corporation, petitioned for leave to intervene for himself and other Iowa contract holders similarly situated and alleging the deposit in trust by debtor corporation in the state of Iowa and alleging debtor's insolvency; on May 3, 1941 an order issued from the District Court in and for Polk County, Iowa granting leave to intervene and prescribing notice to be given to debtor corporation and to Charles R. Fischer, temporary receiver, which notice was duly given.

On May 19, 1941 a decree and order (App. 52-62) issued from the District Court in and for Polk County, appointing Charles R. Fischer, Commissioner of Insurance, as Permanent Receiver for debtor corporation for Iowa. The court found and decreed that title to assets on deposit pursuant to Chapter 392, Code of Iowa, vested in the state of Iowa on the dates they were deposited, and that said title thereto was now by decree vested in Charles R. Fischer as Permanent Receiver for said debtor corporation and ordered said receiver to proceed to wind up the affairs of debtor corporation in Iowa and prescribed notice to be given to the Iowa creditors of debtor corporation and provided for bond to be given as permanent receiver and the District Court retained jurisdiction over the receiver and assets for winding up purposes.

On May 20, 1941 Charles R. Fischer filed final report as receiver *pendente lite*, alleging he is now Permanent Receiver for debtor corporation and praying that he be dismissed and discharged as temporary receiver; on May 22, 1941 the District Court in and for Polk County, Iowa

entered an order dismissing and discharging Charles R. Fischer as temporary receiver of said debtor corporation, and on May 23, 1941, *et seq.*, Charles R. Fischer, Commissioner of Insurance and Permanent Receiver for debtor corporation, issued full and complete notice as prescribed in the order and decree dated May 19, 1941. A certified copy of the Iowa proceedings comprises Ex. 121 (R. 3803 (original)) herein.

The Commissioner of Insurance, as Permanent Receiver for debtor corporation, proceeded to administer the assets of the debtor corporation pursuant to the laws of Iowa up to the time the debtor's petition for reorganization was filed herein. The assets on deposits were not turned over to the federal trustee. The Iowa proceedings have voluntarily been held in *status quo* up to the present time. All of the securities comprising the Iowa deposit have been liquidated and sold and the cash proceeds remain with the Commissioner of Insurance for distribution to contract holders. Preparation is being made for the filing of proofs of claim in the Iowa proceedings.

## PROPOSITIONS RELIED UPON IN THIS BRIEF AND THEIR DISPOSITION BY THE COURTS BELOW

1. The debtor and petitioner is an insurance corporation within the meaning of Section 4 of the Bankruptcy Act as amended (11 U. S. C. A., sec. 22), and as such, ineligible to reorganize under the provisions of Chapter X of the Bankruptcy Act, Act June 22, 1938, c. 575, 52 Stat. 883.

The District Court held that the debtor was not such an insurance corporation, while the Circuit Court of Appeals, reversing the District Court, held that it was.

2. The debtor's petition for reorganization was not filed in good faith within the meaning of Section 144 and subsecs. (3) and (4) of Section 146 of Chapter X (11 U. S. C. A., secs. 541, 546 (3) (4)).

The District Court held that the petition was filed in good faith within the meaning of the designated statutes. The Circuit Court of Appeals, reversing the ruling of the District Court, held that the petition was not filed in good faith within the meaning of Sections 144 and 146 (4). It made no finding as to whether dismissal was also required under Section 146 (3).

3. The public interest, under well settled equity principles applicable in Chapter X proceedings, required dismissal of the petition.

This contention was not ruled upon in either of the courts below.

# ARGUMENT

## I.

## THE DEBTOR IS AN INSURANCE CORPORATION WITHIN THE MEANING OF SECTION 4 OF THE BANKRUPTCY ACT, AS AMENDED, AND AS SUCH INELIGIBLE TO REORGANIZE UNDER THE PROVISIONS OF CHAPTER X OF THE BANKRUPTCY ACT

### A. Insurance corporations are excluded from reorganization proceedings under Chapter X of the Bankruptcy Act

Section 4 of the Bankruptcy Act, as amended, 11 U. S. C. A., sec. 22, reads in part as follows:

> "(a) Any person, except a municipal, railroad, insurance, or banking corporation, shall be entitled to the benefits of this title as a voluntary bankrupt.
>
> "(b) Any natural person, except a wage earner or farmer, and any moneyed, business, or commercial corporation, except a building and loan association, a municipal, railroad, insurance, or banking corporation, owing debts to the amount of $1,000 or over, may be adjudged an involuntary bankrupt upon default or an impartial trial, and shall be subject to the provisions and entitled to the benefits of this title."

Chapter X, Section 106 contains the following provision:

> "For the purposes of this chapter, unless inconsistent with the context—
>
> "• • •

"(3) 'corporation' shall mean a corporation, as defined in this title, which could be adjudged a bankrupt under this title, and any railroad corporation except a railroad corporation authorized to file a petition under section 205 of this title;"

11 U. S. C. A., sec. 506 (3).

The question is squarely presented as to whether the debtor is an insurance corporation and therefore precluded from instituting reorganization proceedings.

**B. The debtor was chartered, licensed and engaged in business as an insurance corporation under the laws of West Virginia, the state of its incorporation**

The debtor was originally organized as a brokerage company and in 1912 its charter was amended to enable it to engage in "the business of soliciting and receiving deposits and payments on any annuity contracts, certificates or annuity bonds." From 1912 to December 31, 1940 it operated under the provisions of Ch. 33, Art. 9, sec. 1 of the West Virginia Code, reading:

"No person, association or corporation shall engage in the business of soliciting or receiving deposits or payments on any annuity contract or certificate or annuity bond in fixed and stipulated installments, within this State, without first having obtained from the insurance commissioner a license to do business in this State: *Provided, however, That this article shall not be construed as applying to* * * * *insurance companies,* * * * *duly authorized to do business in this State,* * * *. Such license shall be issued for one year, or the fractional part of a year, * * * and the provisions of section twelve, article two of this chapter [which provide for expiration April 1 each year] shall apply to such license." (Emphasis supplied)

During this period the debtor operated under the name of Fidelity Investment Association. We made no claim in the court below[1] and make none here that Fidelity was an insurance corporation during that period of its operation. As suggested in the petitioners' brief, it could hardly be regarded as an insurance corporation when such corporations were excluded from the provisions of the statute pursuant to which it was licensed.

On December 31, 1940 by charter amendment Fidelity's name was changed to Fidelity Assurance Association and the following statement of corporate purpose was substituted for that under which it had been operating:

> "To issue insurance upon the lives of persons and every insurance appertaining thereto and connected therewith, and to grant, purchase and dispose of annuities."

A certified copy of the charter amendments and a certificate by the Insurance Commissioner of West Virginia setting out the steps that were taken in connection therewith may be found in Exhibit 24 which is printed at pp. 76 to 78 of the Appendix.

According to the Insurance Commissioner's certificate, application was made to him pursuant to the provisions of Ch. 33, Art. 2, sec. 3 of the West Virginia Code to approve the amendments. That section provides that the Secretary of State may not issue a certificate of incorporation to an insurance company until the Insurance Commissioner shall have approved the charter in writing. Exhibit 24 shows that the Insurance Commissioner approved the amended charter pursuant to sec. 3 and Fidelity's application, on

[1] An intimation to the contrary in petitioner's brief (p. 33) is unfounded.

December 31, 1940. The Secretary of State of West Virginia then issued a certificate of amendment (App. 78-79).

Exhibit 24 also discloses that following the amendment of its charter and on the same day, Fidelity applied to the Insurance Commissioner for a license to engage in the insurance business. A license was issued under the provisions of Ch. 33, Art. 2, sec. 6 to transact such a business in West Virginia. A certified copy of the license is included in Exhibit 24. That part of the exhibit is not printed in the Appendix, since we have had no copy of the document.

At the time the debtor was chartered and licensed as an insurance company and thereafter during all the times involved in these proceedings, the law of West Virginia contained the following provision:

> "Life insurance companies chartered by and doing business in this State, and empowered to make contracts contingent upon life, may grant and issue annuities, either in connection with or separate from contracts of insurance based upon life risks, and all such annuities heretofore issued by such companies shall be valid." (Ch. 33, Art. 3, sec. 7, West Virginia Code)

The license to the debtor to engage in business as an insurance company was issued pursuant to an informal understanding with the Insurance Commissioner that it would enter into no new contracts of any kind until he advised the company that it might do so. The Commissioner testified that he issued the license at the time in order that the debtor would have authority to receive payments under its outstanding contracts (R. 438).

Under its charter and license as a life insurance company the debtor carried on its annuity business by continuing to receive payments upon outstanding contracts, by paying out amounts due on outstanding contracts and

by managing its securities portfolio (R. 182). It does not appear that it attempted to write any further annuity contracts. The same cannot be said, however, with respect to insurance contracts.

At the hearing in the District Court those officials of the debtor who should have been in a position to know of its activities testified that it had issued no insurance policies after its incorporation and licensing as a life insurance company. After the case had been decided by the District Court and while the appeal to the Circuit Court of Appeals was pending, evidence was uncovered which established that the company had in fact entered into life insurance contracts. A motion was made in the Circuit Court of Appeals to remand the case for further testimony. The motion was considered at the same time that the case was argued in the Circuit Court of Appeals, and counsel for all parties stipulated at the bar of that court that certain riders were sent out by the company in December 31, 1940 to the holders of its Series B contracts with the insurance clause.[1] It was stipulated that 9,802 riders were executed by contract holders and returned to the company, and that the total number of outstanding contracts with the insurance clause as of that date was 14,626 (R. 237).

The riders to which this stipulation referred are set out in the statement of facts (*ante*, p. 43-44). We have also set out a letter which accompanied the riders. The letter in plain words advised each contract holder that the company had become authorized to engage in the insurance business; that it desired to assume the insurance provided for in his annuity contract; that it was enclosing a rider which it had executed and by virtue of which it would

[1]The nature of the insurance clause is discussed in the statement of facts, *ante*, p. 8-9.

assume the insurance when the rider had been executed and returned to it.

The debtor and the trustee in their brief do not unequivocally deny that by reason of the execution and return of these riders the company entered into 9,802 insurance contracts. They say, however, that the finding of the Circuit Court of Appeals that the contracts existed was made without "thorough consideration," and that they do not concede such contracts were created. They admit that by virtue of the riders, the company "would have assumed the insurance obligations * * *—when, if ever, * * * [it] could clear with the West Virginia State Auditor and get the right to issue insurance contracts" (Debtor's brief, p. 37).

It is preposterous to contend that any informal understanding with the Insurance Commissioner that it would not issue insurance contracts could invalidate such contracts issued by Fidelity under its unconditional license. There is no suggestion that any of the contract holders who entered into an insurance contract with Fidelity was advised of any such informal agreement. In fact, each holder was advised by the letter accompanying the rider that the company was ready, able and willing to enter into an insurance contract with him. We refuse to seriously consider the implied suggestion by the debtor and the trustee that no insurance agreements were effectuated with the 9,802 contract holders who executed and returned riders.

The brief of the Securities and Exchange Commission refers to Fidelity's insurance obligation as an "illegal gratuitous assumption of a liability" (SEC brief, p. 23). We are not advised in the brief of the respect in which these contracts were illegal; nor are we advised of the respect

in which they were gratuitous. As in the case of the debtor and the trustee, the Securities and Exchange Commission fails to offer anything resembling a valid argument to the effect that these executed insurance riders forming a part of Series B contracts, upon which contract holders continued to pay the amounts called for by the contracts, did not constitute insurance contracts, binding upon the company.

The insurance contracts entered into by the debtor were nonetheless so because it continued to cover its liability by continuing its group insurance policy with Lincoln National. As the Series B contracts with the insurance feature were originally written, the debtor agreed, for a stipulated portion of the payment due on the contract, to obtain insurance that would protect the estate of the contract holder against loss of the contract in the event of his death prior to contract maturity. The debtor carried out its obligations under such contracts by obtaining a group life insurance policy with Lincoln National Life covering such Series B contract holders. After Fidelity itself assumed the insurance risk provided for in these Series B contracts it continued to carry the group policy with the Lincoln National Life. So far as we are advised, any claim against Fidelity arising out of its insurance contract has been paid by Lincoln National Life.

The fact that Fidelity has continued to carry its group policy with Lincoln National, however, does not affect the validity of its own insurance contracts. Actually the practical result of its doing so has been that it has carried reinsurance to the extent of 100% of its own insurance obligation. Had Lincoln National become insolvent to a greater extent than is Fidelity, so that it would be to the interest

of a contract holder to assert a claim against Fidelity directly on his contract, no court would say that Fidelity had escaped its obligation by covering the contract holder through a group policy with Lincoln National. And if today coverage under the group policy with Lincoln National were to be cancelled as applied to those with whom Fidelity has contracted, there could be no question as to Fidelity's liability to those contract holders.

Summarizing the debtor's status as an insurance company under West Virginia law, it is established that it applied for incorporation as a life insurance company under the provisions of law particularly applicable to the incorporation of insurance companies; that it applied for and obtained an unconditional license to transact a life insurance business in West Virginia; that under its charter powers as a life insurance company and under West Virginia law it was empowered to deal in life insurance and in annuities; and that pursuant to its charter and its license it assumed liability on 9,802 life insurance policies and continued to carry on its annuity business except for the writing of new contracts. Debtor thus was chartered and licensed as a life insurance corporation by West Virginia and it transacted business in that state as such.[1]

Opposing briefs, both by the debtor, trustee and the Securities and Exchange Commission, attempt to gloss over Fidelity's status after its incorporation as a life insurance company by repeated statements that it was but a step

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[1]No license was in effect at the time the debtor filed its petition. The license granted on December 31, 1940 expired on April 1, 1941. Application was made for a new license. The license was issued (App. 78), but the payment therefor was later refunded and the license returned. It does not appear as to when this was done except that it was done prior to the time the petition was filed (R. 237). Presumably the Commissioner felt obligated to return the money, since he ordered the company to cease business on April 4, 1941 and took it over under statutory receivership proceedings on April 11, 1941. While the difference is perhaps not material, the renewal license was not refused, as suggested in opposing briefs.

in an abortive "extra-judicial reorganization." They suggest that its incorporation, licensing and transaction of business as an insurance company was an effort to resuscitate the company as a paying business enterprise and that since the effort failed Fidelity cannot be regarded as having become a life insurance corporation. The suggestion implies that something necessary to constitute it a validly organized, licensed and operating insurance company remained uncompleted. Such an implication is contrary to the plain facts of the case, as we have already pointed out.

**C. At the time insurance corporations were excluded from the Bankruptcy Act (1910), life insurance corporations were generally classified as such by reason of their charter powers to insure lives and to "grant, purchase and dispose of annuities"**

We have seen that under the law of West Virginia, life insurance companies are those empowered to issue life insurance and to "grant and issue annuities." We have, moreover, seen that the sole corporate purpose of the debtor was

> "to issue insurance upon the lives of persons and every insurance appertaining thereto and connected therewith, and to grant, purchase and dispose of annuities."

The law of West Virginia in thus classifying debtor as an insurance corporation is the same as that which has existed in the majority of states of the United States for many years.

Insurance corporations were excluded from the Bankruptcy Act by Act June 25, 1910, c. 412, secs. 3 and 4, 36

Stat. 839. At that time twenty-eight states,[1] including the territories of Arizona and New Mexico, classified a life insurance company as a corporation formed for the purpose of insuring the lives of persons and "to grant, purchase and dispose of annuities." The statutory language varies in the several states but the substance is clearly as indicated. We have set out at pages 63-73 in the Appendix the statutory provisions of these twenty-eight states. A typical case is that of New Jersey, where the law provides as follows:

> "Ten or more persons may become a corporation for the purpose of making any of the following kinds of insurance to wit:
>
> "* * *
>
> "—Life.—III. Upon the lives or health of persons, and every insurance appertaining thereto, and to grant, purchase or dispose of annuities;"
>
> Compiled Statutes of New Jersey, (1709-1910) Vol. 2, p. 2838.

It will be noted that this statutory provision defining the purposes for which life insurance corporations may be organized is almost identical with the charter purpose of the debtor.

Twenty states did not in 1910 have statutory provisions such as those pointed out. Some of them defined life insurance corporations as companies issuing insurance on the lives of persons, without making mention of the power to issue any form of annuity contract. Others did not define

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[1] Territory of Arizona, California, Colorado, Connecticut, Illinois, Indiana, Kansas, Kentucky, Louisiana, Maryland, Massachusetts, Michigan, Minnesota, Mississippi, Missouri, Montana, New Jersey, Territory of New Mexico, New York, North Carolina, Ohio, Oklahoma, Oregon, Pennsylvania, Texas, Washington, West Virginia and Wisconsin.

the term. Of these twenty states, however, at least seven[1] have amended their statutes since 1910 to conform to the statutes of the twenty-eight states, to which reference has been made. The statutes of these states are set out in the Appendix at pages 73-75.

It is, of course, an undeniable fact that in the year 1910 there was no commonly accepted meaning attached to the term "life insurance corporation" except as such meaning was derived from the laws of the several states which provided for the incorporation and regulation of such corporations. This is true also today. The federal government did not in 1910, and does not now, assume to incorporate life insurance companies for the purpose of carrying on a general life insurance business. It is established, therefore, that the term "life insurance corporation," in the year 1910 and today, in common, ordinary usage and understanding implies a corporation organized to issue insurance upon the lives of persons and to "grant, purchase and dispose of annuities." Such companies are in many cases empowered also to engage in activities such as writing accident and health insurance. We are not concerned with such powers in this case, however.

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[1] Arkansas, Idaho, Iowa, New Hampshire, Utah, Vermont, Wyoming.

**D. The question as to whether debtor is an insurance corporation within the meaning of the Bankruptcy Act is to be determined either (1) by its classification under the law of West Virginia or (2) by its classification according to the accepted usage and understanding at the time of and since the enactment of the amendment of 1910 excluding insurance corporations from the Act. Under either test the debtor is an insurance corporation.**

The adjudicated cases are not entirely consistent upon the test to be applied in determining whether a corporation falls within the classes excluded from the Bankruptcy Act by the provisions of sec. 4, 11 U. S. C. A., sec. 22. Five circuits, including the Fourth in the present case, hold that the question is to be determined by the classification of a corporation by the laws of the state of its creation, while one circuit holds that Congress intended to exclude such corporations as were generally recognized to be within the excepted classes at the time the Bankruptcy Law was amended to remove them from its operation. It is apparent that there could be no conflict in the two views, however, unless some state were to classify an excluded corporation upon the basis of charter powers other than those which are generally identified with such a corporation. We have found no case in which this has been true.

**1. Authorities holding that classification by the state of incorporation is controlling**

Perhaps the leading case holding to this view is *In re Union Guarantee & Mortgage Co.*, 75 F. (2d) 984, 985 (CCA 2d, 1935), where the court stated the principle in the following language:

"* * * The most natural inference is that Congress meant to leave to local winding up statutes the liquidation of such companies; that, since the states commonly kept supervision over them during their lives, it was reasonable that they should take charge on their demise.[1] * * * Now it is the powers conferred upon the company, not its activities, which are decisive. * * * So far as In re Supreme Lodge of Masons Annuity (D. C.) 286 F. 180, holds otherwise it cannot be accepted. If a state enacts that companies having powers of a prescribed kind must be regulated, that is of course authoritative; and, if in addition it classes the company as a bank or a railroad or an insurer, that too should be authoritative. Kansas v. Hayes, 62 F. (2d) 597 (C. C. A. 10); Security B. & L. Ass'n v. Spurlock, 65 F. (2d) 768 (C. C. A. 9). This is true, not because Congress was bound to yield in such cases, but because otherwise its apparent purpose to leave the winding up of such companies to the state would not be effected; for the will of the state is no clearer to supervise the company than to class it as it does. When Congress excepted not all companies affected with a public interest, but specified kinds of such company, presumably it intended the states to define the kinds."

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[1]The court's inference was properly drawn. Mr. Jacob Weinstein, a member of the National Bankruptcy Conference, who assisted in the drafting of Ch. X and who appeared at the hearings before the House Committee on Judiciary to explain the bill, stated that such was the purpose of its framers. He said:

"We have a letter from Mr. E. R. Elliott, an attorney of St. Louis, Mo. Mr. Elliott suggests that insurance companies be brought within the scope of corporate reorganizations. The conference has thoroughly canvassed and considered that whole subject of persons amenable to reorganization proceedings, and they have decided that in the case of insurance companies and banking corporations and the like, they be not brought within the scope of the reorganization proceedings. The cases of these companies, which are now excluded from the act—the various States have set up, first, controlling agencies in the operation of the companies; and, secondly, when companies become embarrassed, the agencies, in order to take care of them and to liquidate them, when necessary, and it is the judgment of the conference that it would be much better to allow these companies to be liquidated or reorganized under local law, than to bring them in under the bankruptcy law * * *" (House Committee on Judiciary, Hearings on H. R. 6439, 75th Congress, 1937-38, p. 242)

Cases from other circuits so holding are:

*Grand Lodge, Knights of Pythias v. McKee*, 95 F. (2d) 474 (CCA 5th, 1938);

*State of Kansas v. Hayes*, 62 F. (2d) 597 (CCA 10th, 1932);

*Security Building & Loan Ass'n v. Spurlock*, 65 F. (2d) 768 (CCA 9th, 1933).

**2. The view that a generally recognized rather than a local state classification is controlling**

The highest authority that we have found supporting the view that local classification is not controlling is *Gamble v. Daniel*, 39 F. (2d) 447 (CCA 8th, 1930). There the question was whether a corporation organized under the laws of Nebraska was excluded from the Bankruptcy Act as a banking corporation. The court discussed the matter as follows:

"* * * We have no doubt that when Congress used the words 'banking corporations' it meant corporations which were authorized by the laws of their creation to do a banking business.

"* * * When Congress spoke of 'banking corporations' it spoke as of 1910. It used the words in no technical nor special sense, but as they were then ordinarily understood. As that time, the ordinary conception of a bank was of a business which was based primarily on the receipt of deposits (general or special), which deposits were used by the bank for loans, discounts, buying and selling commercial paper, and other business purposes. * * * Without attempting a full definition of these words used in this section of the Bankruptcy Act (as amended), this necessary element of deposits is stressed because it is important in this case.

"Having in mind the above construction of the words in the Bankruptcy Act, we turn to the statutes of Nebraska to ascertain the powers of this company. In such examination we are not bound by terminology, but are seeking to ascertain the actual powers granted. * * *." *Gamble v. Daniel*, 39 F. (2d) 447, 450-451.

The case of *In re Supreme Lodge of the Masons Annuity*, 286 F. 180 (N. D. Ga., 1923), also holds to this view.

**3. Cases involving possible qualifications of the local state classification rule need not be considered**

It is not necessary for the purposes of this case to consider whether the rule of *In re Union Guarantee & Mortgage Co.*, 75 F. (2d) 984 (CCA 2d, 1935) was modified by the Second Circuit Court of Appeals in the case of *In re Prudence Co.*, 79 F. (2d) 77 (CCA 2d, 1935).

It might be contended on the basis of the *Prudence* case that a state could not classify a corporation as a "railroad, insurance, or banking corporation" unless its charter purposes and the law under which it does business permit it to exercise some of the powers which have been commonly accepted as belonging to such corporations. But see *Empire Title & Guarantee Co. v. United States*, 101 F. (2d) 69 (CCA 2d, 1939). Neither is it necessary to consider other cases where it might likewise be contended that the rule of local state classification might be so limited.

*Cf. Clemons v. Liberty Savings & Real Estate Corporation*, 61 F. (2d) 448 (CCA 5th, 1932);

*Woolsey v. Security Trust Co.*, 74 F. (2d) 334 (CCA 5th, 1934).

In the present case the debtor was classified as a life insurance corporation upon the basis of charter powers which are generally characteristic of life insurance corporations.

If a state were to enact that any corporation organized under its laws should be an insurance corporation, and if it were claimed that a corporation organized under its laws to operate a restaurant were an insurance corporation and excluded from the Bankruptcy Act, it might be contended with some force that the federal courts should refuse to follow the state classification. Such a case has not arisen to date, however, though many years have elapsed since these various types of corporations were excluded. Nor is it probable that the courts will be confronted with such a case. But if the time comes when states thus abuse the power that Congress has relinquished to them to reorganize and liquidate these particular classes of corporations, the Congress may, by a change of definitions or by removal of the exclusion clause altogether, adequately deal with the situation.

**4. Debtor is an insurance corporation whether regard be had to its West Virginia classification or whether it be judged on the basis of a generally recognized classification**

We have already pointed out that the debtor was organized as a life insurance corporation under the laws of West Virginia and that it was licensed and did business as such. If its status is to be determined upon the basis of its classification under the law of West Virginia, then it must necessarily be an insurance corporation.

If we turn from the matter of local classification and regard the debtor's status upon the basis of the general and

accepted meaning of the term "life insurance corporation" at the time such corporations were excluded from the Act in 1910 by Act June 25, 1910, c. 412, secs. 3 and 4, 36 Stat. 839, it is likewise established, as we have shown, that the debtor is an insurance corporation.

**E. There is no merit to the contention that the debtor's status as an insurance corporation is to be determined by considering the nature of its predominant activity and that, as so determined, it is not an insurance corporation**

The debtor, the trustee and the Securities and Exchange Commission have contended throughout this case that the debtor's status as an insurance corporation is to be determined by application of what those of us interested in the case have denominated the "activities doctrine." They wholly reject the rule that the status of a corporation is to be determined by its classification under the laws pursuant to which it was organized. They agree with the one Circuit Court of Appeals decision, *Gamble v. Daniel*, 39 F. (2d) 447 (CCA 8th, 1930); which rejects the local classification rule and adopts a rule of generally recognized classification. They disagree with the *Gamble* case, however, in that they contend a corporation's status should be determined by its predominant activity rather than its charter powers, whereas the *Gamble* case holds that classification by charter power is the proper rule. They thus stand without support for their doctrine from any Circuit Court of Appeals decision construing the exclusion clause of the Bankruptcy Act now under consideration. The proposition contended for by the petitioners and the Securities and Exchange Commission was accepted by the District Court and was thus stated in its decision:

"In deciding whether a corporation is to be classified as an insurance or banking corporation or a building and loan association within the meaning of the Bankruptcy Act, the court must first examine the provisions of its corporate charter. If the charter authorizes the company to engage in business in any of the excepted fields, and if the company in fact engages principally in a business which lies within that field, such a corporation must be treated as one excluded from the benefits of Chapter X. However, if its charter authorizes the corporation to engage in activities outside the excepted fields, and if all the business actually done by the corporation is outside those fields, then it must be treated as not being within any of the excluded classes. By this test Debtor must be classified as a corporation which is not an insurance corporation within the meaning of the exemption provisions of the Bankruptcy Act. * * *." (R. 189)

The court then distinguished "insurance annuities" (life annuities) from "investment annuities" (annuities for a term of years). It held that the only business conducted by the debtor under its charter and license as a life insurance company involved "investment annuities" and that it did not, therefore, transact an insurance business.[1] Accordingly, the court held that since transactions in investment annuities constituted the debtor's only business and since such annuities were not insurance, the debtor was not an insurance corporation.

It should be remarked, first of all, that the District Court erred in the distinction it attempted to draw between "insurance annuities" and "investment annuities." It is to be inferred from its decision that had Fidelity's activities

[1] The issuance of life insurance contracts was not known to the court. See discussion ante, p. 66.

after its incorporation as a life insurance company consisted of dealings with reference to life annuities, it would be regarded as a life insurance company. But no annuity contract, either for life or for a period of years, is an insurance contract.

*Helvering v. LeGierse*, 312 U. S. 531, 541-542, 85 L. ed. 996, 61 S. Ct. 646 (1941);

*Old Colony Trust Co. v. Commissioner of Internal Rev.*, 102 F. (2d) 380 (CCA 1st, 1939);

*Rishel v. Pacific Mut. Life Ins. Co. of California*, 78 F. (2d) 881 (CCA 10th, 1935);

*In re Walsh*, 19 F. Supp. 567 (D. C. Minn., 1937);

*Commonwealth v. Metropolitan Life Ins. Co.*, 254 Penn. 510, 98 A. 1072 (1916);

*State v. Lucas*, (Mo.) 153 S. W. (2d) 10 (1941);

*Curtis v. New York Life Ins. Co.*, 217 Mass. 47, 104 N. E. 553 (1914);

*People v. Knapp*, 193 App. Div. 413, 184 N. Y. S. 345 (1920), affirmed 231 N. Y. 630, 132 N. E. 916 (1921);

*Daniel v. Life Ins. Co. of Virginia*, (Tex. Civ. App.) 102 S. W. (2d) 256 (1937);

*State v. Equitable Life Assur. Soc.*, 68 N. D. 641, 282 N. W. 411 (1938);

*Northwestern Mut. Life Ins. Co. v. Murphy*, 223 Ia. 333, 271 N. W. 899 (1937);

*State v. Ham*, 54 Wyo. 148, 88 P. (2d) 484 (1939).

Life insurance corporations under their charter power to deal in annuities may issue such annuities for life, upon

the basis of mortality tables, or for a certain period without regard to mortality tables, as in the case of Fidelity's annuities.

*Carroll v. Equitable Life Assur. Soc. of United States*, 9 F. Supp. 223, 224 (D. C. Mo., 1934);

*Daniel v. Life Ins. Co. of Virginia*, (Tex. Civ. App.) 102 S. W. (2d) 256, 260 (1937).

And life insurance corporations conducting an annuity business under a life insurance charter to deal in life insurance and annuities and under a license to conduct a life insurance business are regarded as engaged in a life insurance business. As stated by the Supreme Court of Massachusetts:

> "And the conclusion is irresistible that if the petitioner had issued only contracts for the payment of annuities, it must be deemed to be a life insurance company. If so it would be accurately described as in 'the business of life insurance.' It is none the less so engaged because it also issues policies of life insurance. * * *." *Mut. Ben. Life Ins. Co. v. Commonwealth*, 227 Mass. 63, 116 N. E. 469, 470 (1917)

and by the Supreme Court of Iowa:

> * * * That these words 'business done in this state' were inclusive of the granting and selling of annuities was made definitely certain by legislative enactment prior to the year 1934. That is, the Legislature had identified the granting and selling of annuities as a part of the business permitted and anticipated to be done in this state by insurance companies in the enjoyment of their business licenses. Reference is to chapter 147 of the Acts of the Forty-fifth General Assembly, which

added to chapter 308 of the 1931 Code, section 8673-a, which provides that 'any life insurance company organized on the stock or mutual plan may grant and sell annuities. * * *.' *Northwestern Mut. Life Ins. Co. v. Murphy*, 223 Ia. 333, 271 N. W. 899, 902 (1937)

See also: *State v. Lucas*, 348 Mo. 286, 153 S. W. (2d) 10 (1941).

It must therefore be concluded that, even assuming the rule of law applied by the District Court to be applicable, it was misapplied in that if the annuity business done by Fidelity after its incorporation as a life insurance company constituted its predominant activity, the activity nevertheless was that of a life insurance company doing a life insurance business. The situation is comparable to the activity of the trust department of a banking corporation. Banking corporations authorized to conduct a trust business are nevertheless banking corporations, and the trust department cannot be considered apart from the corporation which conducts it and be regarded as something other than a banking business. *Sterling v. Tantum*, 5 Boyce (28 Del.) 409, 94 A. 176, 182.

An annuity business may be transacted by a corporation other than a life insurance corporation. Such a business may also be transacted by a life insurance corporation. Thus, the fact that a corporation transacts an annuity business is not, of itself, significant in determining the character of the corporation.

The District Court, in addition to misapplying the "activities doctrine" as stated in its opinion, further erred in accepting the contention also made here that there is any such doctrine recognized by the authorities in construing the exclusion provision of Section 4. The debtor, the trus-

tee and the Securities and Exchange Commission rely for the most part on cases such as *Cate v. Connell*, 173 F. 445 (CCA 1st, 1909), *In re Kingston Realty Co.*, 160 F. 445 (CCA 2d, 1908), *In re Interstate Paving Co.*, 171 F. 604 (D. C. N. Y., 1909), arising under Section 4 prior to its amendment by Act June 25, 1910, c. 412, 36 Stat. 839. The inapplicability of these cases was pointed out by the Circuit Court of Appeals. They arose under the statute at a time when it provided that the amenability of a corporation to involuntary bankruptcy was to be determined by its principal pursuit. It was to avoid the uncertainty and confusion produced by the application of the statutory activities test that the 1910 amendment was made.

*Gamble v. Daniel*, 39 F. (2d) 447 (CCA 8th, 1930).

Another line of authority upon which the petitioners and the Securities and Exchange Commission rely is constituted by cases such as *In re Roumanian Workers Educational Ass'n.*, 108 F. (2d) 782 (CCA 6th, 1940), which are concerned with determining whether a corporation is a "moneyed, business or commercial corporation" within the meaning of Section 4. The inapplicability of these cases was likewise pointed out in the opinion by the Circuit Court of Appeals.

The only case which directly supports petitioners' view as to the existence of an "activities doctrine" is *In re Supreme Lodge of the Masons Annuity*, 286 F. 180 (N. D. Ga., 1923), which is contrary in that respect to the decisions of the Court of Appeals for that circuit. *Cf. Grand Lodge, Knights of Pythias v. McKee*, 95 F. (2d) 474 (CCA 5th, 1938). In that case the court remarked that the charter powers of a corporation should be resorted to in most in-

stances for the purpose of determining its classification, and that in extreme cases resort might be had to activities rather than charter powers. The court by way of illustrating the application of the "activities doctrine" referred to a Georgia corporation which had obtained an ancient grant of a charter containing power to operate a railroad and a bank. It remarked that the company at no time had operated a bank, and that in order to determine its character the business actually done under its charter should control.

It may be that in a proper case there would be occasion to resort to an "activities doctrine." If under state law a corporation in a particular case were not clearly classified and if its charter powers and activities were broad enough to include operations both within and without the fields in which insurance, banking, building and loan corporations, etc. usually operate, a court might find it necessary to look to the business actually done, or to those charter powers actually exercised, in determining the true character of the corporation. Such, however, is not the case here, and it is not probable that such a case will often arise. Insurance, banking, building and loan and railroad corporations are almost universally regarded as being affected with a public interest and are closely regulated by the states. In line with this regulation, the purposes for which such corporations may be organized are usually defined to exclude non-related enterprises. This is certainly true in the field of life insurance. A study of the statutes relating to life insurance corporations which we have set out at pp. 63 to 75 of the Appendix indicates the uniformity of the law of the various states, certainty of classification, and the exclusion of non-related enterprises.

**F. The petitioners' contention that the Investment Company Act of 1940 has defined the term "insurance corporation" as used in Section 4 of the Bankruptcy Act, as amended in 1910, and that, as so defined, Fidelity is not an insurance corporation, is without merit**

The petitioners contend in this court that even if the term "insurance corporation," as inserted in Section 4 of the Bankruptcy Act by the 1910 amendment, was not defined, it has now been defined by the Investment Company Act of 1940 and that, as so defined, the term does not include Fidelity. Under the Investment Company Act of 1940 the term "face amount certificate" is created and defined (15 U. S. C. A., sec. 80a-2 (a) (15)). The term embraces both life and term annuities and other comparable contracts which are not material here. The term "investment company" is also created and defined (15 U. S. C. A., sec. 80a-3 (a) (2)). An "investment company" is a company issuing face amount certificates or other defined types of investment contracts. The term "face amount certificate company" is created and defined (15 U. S. C. A., sec. 80a-4 (1)). A "face amount certificate company" is an investment company dealing in face amount certificates. Since any annuity is a face amount certificate, and since companies dealing in face amount certificates are face amount certificate companies, all life insurance companies would be regulated under the Investment Company Act, were it not for the exclusion made by 15 U. S. C. A., sec. 80a-3 (c) (3) and 80a-2 (a) (17). These sections define and exclude insurance companies from the definition of "investment companies" and "face amount certificate companies." As so defined and excluded, insurance companies are those whose

primary and predominant business activity is the writing of insurance policies and which are subject to supervision by the insurance officials of the various states.

In addition to providing extensive regulation for face amount certificate companies and other investment companies, the Investment Company Act of 1940 amended two sections of the Bankruptcy Act, namely Section 44 (a) (11 U. S. C. A., sec. 72 (a)) dealing with the appointment of trustees in bankrupt estates and Section 67 (11 U. S. C. A., sec. 107) dealing with liens upon, and fraudulent transfers of, the property of bankrupts. The amendment of Section 44 (a) provided that if a bankrupt were a face amount certificate company, the court should appoint the trustee upon giving the Securities and Exchange Commission an opportunity to be heard, and the creation of Section 67 (f) provided a method for equalizing the distribution in bankruptcy of state deposits made after January 1, 1941 by face amount certificate companies.

The petitioners argue that on the basis of these provisions of the Investment Company Act of 1940, the Congress has created a type of company known as a face amount certificate company; that the term "face amount certificate company" is created, among other things, for the purpose of the Bankruptcy Law; that it is clearly contemplated that face amount certificate companies may become bankrupts; that face amount certificate companies include insurance corporations whose primary and predominant business does not consist of writing insurance policies, and that consequently no face amount certificate company is an insurance corporation within the meaning of Section 4 of the Bankruptcy Act, as amended in 1910, excluding such corporations from bankruptcy.

This argument was not advanced in the court below and is not pressed in this court by the Securities and Exchange Commission.[1]

In enacting the Investment Company Act of 1940 Congress specifically directed its attention to amending the Bankruptcy Act. That act was amended in two particulars, neither of which related to the provisions (Section 4) specifying those who might become bankrupt. Both of the amended sections, 44 and 67, relate to the administration of assets of those who have been adjudged bankrupt. Had Congress intended to deal with the question of those who might become bankrupt, it could easily have done so. Had it intended to define the term "face amount certificate company" for purposes of Section 4 of the Bankruptcy Act and to provide that the undefined term "insurance corporation" used in that section should not include a face amount certificate company, it could easily have done so by express language. It is unbelievable that it could have intended to do these things through the process of tenuous indirection contended for.

The fact that Section 4 remained unchanged in the face of the other specific changes in the act is in itself persuasive that Congress addressed itself to the subject of

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[1]The Securities and Exchange Commission, however, advances the contention that if insurance corporations are to be classified according to the law of the state of incorporation, as held by the court below, the result may be that the definition of the term "insurance company" under the Investment Company Act of 1940 may be affected. We can see no ground for such a contention. Under the Investment Company Act of 1940 the term "insurance company" as there used is defined as a company whose primary and predominant business activity is the writing of insurance. The definition of that term for the purposes of that act would necessarily control in the application of that act. The fact that for the purposes of the Bankruptcy Act the term "insurance corporation" may be judicially defined otherwise in the absence of legislative definition, in no way bears upon the administration of the Investment Company Act. The term "insurance corporation" may have a different meaning as defined for the purposes of different acts. See 26 U. S. C. A., sec. 201 (a), where life insurance companies are defined for purposes of taxation, and 15 U. S. C. A., sec. 605i, where they are defined for purposes of Reconstruction Finance Corporation lending. A face amount certificate company could be a life insurance corporation for purposes of taxation or purposes of RFC lending, even though it were not an insurance company for the purposes of the Investment Company Act of 1940. There is no reason why the same difference could not exist between the Investment Company Act and the Bankruptcy Act.

changing the act and intended no changes other than those expressly provided for.

*Sampayo v. Bank of Nova Scotia*, 313 U. S. 270, 85 L. ed. 1324, 61 S. Ct. 953 (1941)

No one contends that face amount certificate companies were first made amenable to the Bankruptcy Act by the Investment Company Act of 1940. While the term was first defined in the Investment Company Act, the companies to which it was applied had long been in existence and many of them were subject to the Bankruptcy Act as "moneyed, business or commercial corporations" not otherwise exempt as insurance corporations, etc. under Section 4. During its existence as an annuity company under West Virginia law Fidelity was subject to the Bankruptcy Act. Those who framed the Investment Company Act were obviously aware that such companies were amenable to bankruptcy, and there is no reason to suppose that in amending the Bankruptcy Act they were doing anything other than providing for the administration in bankruptcy of the assets of those companies.

The doctrine of implied amendment and implied repeal is not favored. If a subsequent statute which does not expressly change an existing provision can be given effect without being interpreted as so amending the provision, it will not be regarded as having been intended to do so.

*Nelson v. Nelson*, 209 P. 810, 72 Colo. 20;

*Hamilton County Bd. of Com'rs v. State*, 111 N. E. 417, 184 Ind. 418;

*People v. Illinois Cent. R. Co.*, 145 N. E. 719, 314 Ill. 339;

*Starbird v. Brown*, 24 A. 824, 84 Me. 238, 240;

and see, generally, cases cited in 59 C. J. 857. Applying this rule to the situation at hand, it is evident that no amendment of Section 4 of the Bankruptcy Act can be implied. (There is no contention of an express one.) Had face amount certificate companies been excluded from bankruptcy prior to the enactment of the Investment Company Act which made provision for their administration in bankruptcy, they would impliedly have been made amenable to the Bankruptcy Law. The provision for the administration of their assets would have been inconsistent with their exclusion. However, since there were face amount certificate companies as defined in the Investment Company Act which were amenable to bankruptcy prior to the enactment of the Investment Company Act, there is no ground for supposing that Congress intended going further than to provide for administering the assets of such companies. There is no reason to suppose that Congress intended to provide for the administration of the assets of face amount certificate companies otherwise excluded by the Bankruptcy Act and thus to amend the excluding provisions. The term "insurance corporation" as used in Section 4 of the Bankruptcy Act can be given the meaning attributed to it by the courts without in any way conflicting with the Investment Company Act of 1940. The term "face amount certificate company" and the term "insurance company" as used in the Investment Company Act of 1940 can be given full effect without in any way conflicting with the judicial interpretation of the term "insurance corporation" as used in Section 4 of the Bankruptcy Act. Under such circumstances there is no room for the doctrine of implied amendment.

It is established, in view of the foregoing, that in enact-

ing the Investment Company Act of 1940 Congress did not intend to supersede the judicial definition of the term "insurance corporation" as used in Section 4 of the Bankruptcy Act and that the decisions relied upon by the court below remain authoritative.

**G. The question as to whether the debtor is an insurance corporation is to be determined by its status at the time the petition was filed. At that time it was an insurance corporation. It is not material that prior to December 31, 1940 it was not an insurance corporation or that the major portion of its assets and liabilities was acquired prior to the time it became an insurance corporation**

We have pointed out that the debtor was incorporated as an insurance company in West Virginia on December 31, 1940 and that it was licensed and did business as such in West Virginia. At the time the present proceedings were instituted, June 6, 1941, the debtor had been placed in receivership by the Insurance Commissioner under the provisions of West Virginia law. It was not at that time transacting any business, except such as was transacted through the receivers. For purposes of this proceeding, however, we look to its status at the inception of the receivership.

*In re Peoria Life Ins. Co.*, 75 F. (2d) 777 (CCA 7th, 1935);

*In re Union Guarantee & Mortgage Co.*, 75 F. (2d) 984 (CCA 2d, 1935).

At that time the debtor existed as an insurance corporation under West Virginia law.

It seems to be the contention of the petitioners and the Securities and Exchange Commission that since the

debtor acquired the status of an insurance corporation but a few months prior to the time it was taken over by the Insurance Commissioner, its status as such a corporation should be disregarded in these proceedings. Thus, the petitioners stress the argument that a corporation should not be permitted to change its classification to that of a corporation excluded from bankruptcy and thereby to deny its creditors the benefits of bankruptcy. The Securities and Exchange Commission emphasizes that the principal assets and liabilities of the debtor were acquired prior to the time it became an insurance corporation; that it is such assets and liabilities which are to be administered, and that accordingly it should be regarded as occupying the status it had during the time it acquired the assets and liabilities. We may note parenthetically that the record does not show a comparison of the assets and liabilities acquired by Fidelity before and after December 31, 1940. After that time it received substantial amounts of money and incurred substantial obligations on its contracts. It also acquired liability under its insurance contracts, although the extent to which claims may arise out of such contracts will be contingent upon factors such as whether the re-insurance agreement is continued.

The contention of the petitioners is clever. It stresses the denial to creditors of the benefits of bankruptcy through change in the debtor's status. One would almost think that the creditors had instituted this proceeding. But such is not the case. It was instituted by the debtor. In the very nature of things different considerations must obtain in the two cases.

*Chicago T. & T. Co. v. Forty-One Thirty-Six W. Corp.*, 302 U. S. 120, 82 L. ed. 147, 58 S. Ct. 125 (1937);

The right of the creditors is amply provided for by permitting them to file an involuntary petition in a proper case.

On December 31, 1940 the debtor applied to West Virginia for permission to incorporate as a life insurance corporation under West Virginia law. The permission was granted. It invoked the protection of West Virginia law,—it assumed the status of a life insurance corporation under West Virginia law for purposes which it considered beneficial to it. The regulatory provisions of the Investment Company Act of 1940 became effective January 1, 1941, one day following the debtor's incorporation as a life insurance company. It has been conceded by everyone in this case that the change was made for the purpose, among others, of escaping the regulatory provisions of the Investment Company Act. As to just how this was to be done has not yet been fully disclosed. Several theories are plausible. But whatever its plan may have been, the debtor thought that by assuming the status of a life insurance corporation under West Virginia law its chances of continuing in business would be enhanced.

West Virginia has enacted regulation appertaining to the incorporation and supervision of life insurance companies.[2] The debtor voluntarily assumed the status of a life insurance corporation in West Virginia. But after some months of effort, it found itself unable to continue business. It then utilized its corporate authority, enjoyed by virtue

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[1]The Supreme Court did not accept all the reasoning of the Circuit Court of Appeals. Cf. **Marine Harbor Properties, Inc. v. Manufacturer's Trust Co.**, ——, U S ——, 87 L. ed. (adv.) 73, 63 S. Ct. 93. But we do not understand that the lower court was overruled on the proposition to which it is cited.

[2]It was because of the adequacy of such regulation, including liquidation and reorganization proceedings, that insurance corporations were excluded from the Bankruptcy Act (ante, p. 74).

of its existence as a West Virginia life insurance corporation, and filed a petition in federal District Court denying that it was a life insurance corporation and basing its claim for relief upon that denial. These facts speak for themselves.

As to the claim that the debtor's status at the time it acquired the major portion of its assets and liabilities should control, there are helpful precedents.

The Bankruptcy Act has long provided for voluntary petitions by farmers and wage earners, but it has exempted them from involuntary proceedings (Section 4 (b), 11 U. S. C. A., sec. 22 (b)). Since natural persons are by nature empowered to engage in an infinite variety of occupations, it has been necessary to define the terms "wage earner" and "farmer" upon the basis of their primary and principal activities (Section 1 (17), (32), 11 U. S. C. A., sec. (1) (17), (32)). In administering the Bankruptcy Act cases have occurred where one incurred assets and liabilities as a farmer and thereafter engaged in an occupation not exempt from involuntary bankruptcy. Other cases have occurred where persons have incurred assets and liabilities in an unexempt occupation and have thereafter assumed the status of a wage earner or farmer. There is some authority for the proposition that the status of a farmer or wage earner for the purpose of amenability to bankruptcy is to be determined as of the time that his assets and liabilities were acquired.

*In re Burgin*, 173 F. 726 (D. C. Ala., 1909);

*In re Crenshaw*, 156 F. 638 (D. C. Ala., 1907).

It is the general rule, however, that status is to be determined as of the time of an act of bankruptcy.

*Smith v. Brownsville State Bank*, 15 F. (2d) 792 (CCA 8th, 1926);

*Flickinger v. First National Bank*, 145 F. 162 (CCA 6th, 1906);

*Counts v. Columbus Buggy Co.*, 210 F. 748 (CCA 4th, 1913);

*In re Inman*, 57 F. (2d) 595 (D. C. Wyo., 1932);

*In re Folkstad*, 199 F. 363 (D. C. Mont., 1912);

1 Remington on Bankruptcy (4th ed.) 175.

The status of a person during the time when assets and liabilities were acquired is held by the weight of authority to be material only in so far as it bears upon what his chief occupation was at the time an act of bankruptcy was committed.

*Powers v. Silberman*, 3 F. (2d) 802 (CCA 3rd. 1925);

*In re Brown*, 253 F. 357 (CCA 9th, 1918);

*In re Inman*, 57 F. (2d) 595 (D. C. Wyo., 1932);

*In re Brown*, 284 F. 899 (D. C. Mo., 1922);

*In re Disney*, 219 F. 294 (D. C. Md., 1915).

In order to remove any doubt about the question Congress, following the majority rule, has enacted that the status of a person as a farmer or wage earner is to be determined as of the time an act of bankruptcy is committed. (Bankruptcy Act, Section 22 (b), as amended by Act June 22, 1938, c. 575, sec. 1, 52 Stat. 845). It is thus the legisla-

tive policy that status at the time assets and liabilities are acquired is not determinative.

*In re Harriman*, 31 F. Supp. 50 (D. C. N. Y., 1939)

By analogy to the cases and congressional policy dealing with the status of a person as a farmer or wage earner, the status of a corporation at the time of acquiring the major portion of its assets and liabilities should not determine its amenability to bankruptcy.[1] In a case of ordinary bankruptcy, even where the proceedings are involuntary, the status of the corporation at the time of the alleged act of bankruptcy should govern, although it may be conceded that a corporation could not, shortly before such an act, join the class of those excluded from bankruptcy with the intention of avoiding an involuntary petition.

*In re Inman*, 57 F. (2d) 595 (D. C. Wyo., 1932).

So far as Chapter X is concerned, we may assume that a similar rule would obtain. We may assume that if a corporation committed an act of bankruptcy and thereafter changed its classification within four months, it would nevertheless be amenable to an involuntary petition at the suit of its creditors (Bankruptcy Act, Section 131, 11 U. S. C. A., sec. 531). We may assume, moreover, that if any of the other matters had occurred, which under Section 131 invest creditors with the right to institute involuntary proceedings, a corporation could not thereafter change its status while the basis for jurisdiction continued to exist. Since this suit is not instituted by creditors, however, the question is not material and, even if it were, no basis would be

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[1] Neither is it significant in determining the status of a corporation at any other time, since the corporate exclusion provision is not based upon a principal, activities test by Section 4 or by the decisions construing it.

afforded for holding the debtor amenable to Chapter X under the facts of the case. We may also assume that a corporation could not change into an excluded class for purposes of avoiding a Chapter X petition by creditors knowing that shortly thereafter it would commit an act of bankruptcy or suffer one of the contingencies to befall it which constitute a ground for the filing of an involuntary petition. But there is no evidence that Fidelity changed its classification with any such idea in mind, and none of those supporting the petition have ever ventured the suggestion that it entertained such an idea.

## II

## THE PETITION FOR REORGANIZATION WAS NOT FILED IN GOOD FAITH

Assuming for the purpose of argument that debtor were not an insurance corporation, its petition was not filed in good faith.

### A. Statutes

Section 130 (7) of Chapter X of the Bankruptcy Act, Act June 22, 1938, 52 Stat. 883 (11 U. S. C. A., sec. 530 (7)), provides that every petition shall state "the specific facts showing the need for relief under this chapter and why adequate relief cannot be obtained under chapter 11 of this act."

Section 144 of Chapter X (11 U. S. C. A., sec. 544) provides:

> "If an answer filed by any creditor, indenture trustee, or stockholder shall controvert any of the material allegations of the petition, the judge shall, as soon as may be, determine, without the intervention of a jury, the issues presented by the pleadings and enter an order approving the petition, if satisfied that it complies with the requirements of this chapter and has been filed in good faith and that the material allegations are sustained by the proofs, or dismissing it if not so satisfied."

Section 146 of Chapter X (11 U. S. C. A., sec. 546), insofar as material here, provides:

> "Without limiting the generality of the meaning of the term 'good faith,' a petition shall be deemed not to be filed in good faith if—
>
> "(1) * * *
>
> "(2) * * *

"(3) it is unreasonable to expect that a plan of reorganization can be effected; or

"(4) a prior proceeding is pending in any court and it appears that the interests of creditors and stockholders would be best subserved in such prior proceeding."

**B. The petition should have been dismissed pursuant to Section 146 (3) on the ground that it was unreasonable to expect that a plan of reorganization could be effected**

**1. The question as to whether the petition was filed in good faith within the meaning of Section 146 (3) of Chapter X was raised in the District Court and in the Circuit Court of Appeals and is open for argument in support of the judgment of the Circuit Court of Appeals.**

In *Ryerson v. United States*, 312 U. S. 405, 85 L. ed. 917, 61 S. Ct. 656 (1941), it was held that a respondent in a matter brought before the court by certiorari might advance any proposition in support of the judgment of the court below which was argued in that court.

**2. The purpose of Chapter X is to provide for the rehabilitation of corporations as going concerns, and the provisions of Section 146 (3) were framed in the light of that purpose. Neither the debtor's petition nor the proof demonstrates that it is entitled to the benefits of Chapter X.**

**a. The purpose of Chapter X and the requirements under Section 146 (3)**

The fundamental purpose of Chapter X and its predecessor, Section 77B, was to provide means for the rehabilitation of corporations in order to preserve values inherent

in their continuance as going business enterprises. The purposes of Chapter X are sharply distinguished from the purposes of straight bankruptcy or other proceedings, having for their purpose the liquidation of the assets of business concerns and their distribution to creditors. This fundamental difference is explained at pp. 2-3 of Finletter, Law of Bankruptcy Reorganization (1939 ed.), where it is said:

> "Now there is one underlying fact about these laws (and their successors, the reorganization chapters of the 1938 Act) which colors their whole quality. They are not bankruptcy laws at all. Bankruptcy procedure is a method of liquidation, and the reorganization provisions of the Act are codifications of the old federal equity receivership whose purpose is the opposite one of reorganization. *The rules of law which make up the equity procedure were conceived with reference to the continuance of the enterprise as a going concern.* The statutes and decisions which constitute the law of bankruptcy were formed with the object of liquidating the business and obtaining the maximum amount of cash for distribution to the creditors. The interpretation of the new reorganization chapters of the Act accordingly must recognize their real ancestry. The principles of the equity receivership underlie nearly every substantive provision of the new amendments.
>
> "The reason that the new laws are in the Bankruptcy Act is entirely a question of constitutionality. * * *" (Emphasis supplied) Finletter, Law of Bankruptcy Reorganization (1939 ed.) pp. 2-3.

See entire discussion of "Origins of Reorganization Provisions," Finletter (1939 ed.), pp. 1-35, and

*Warner Bros. Pictures v. Lawton-Byrne-Bruner Ins. A. Co.*, 79 F. (2d) 804, 810-811 (CCA 8th, 1935).

As said in *In re Dutch Woodcraft Shops*, 14 F. Supp. 467 (D. C. W. D. Mich., 1935):

> "Obviously, the essential purpose of section 77B is to preserve and continue a going business but in cases where going concern values have been wholly or practically eliminated, the case is one for liquidation rather than for reorganization. The preservation of business enterprises must not be at the expense of creditors, and the provisions of sec. 77B should not be taken advantage of to effect what, in fact, amounts to a composition under sec. 12 (11 U. S. C. A., sec. 30)."

See citation of a portion of the foregoing language and discussion of the *Dutch Woodcraft Shops* case in *Case v. Los Angeles Lumber Products Co.*, 308 U. S. 106, 84 L. ed. 110, 60 S. Ct. 1 (1939) (at 308 U. S., footnote 120-121).

Section 146 of Chapter X, the "good faith" provision, and subsec. (3) thereof must be interpreted, as were the "good faith" provisions of Section 77B, in the light of the fundamental purpose of Chapter X. Good faith was found wanting in Section 77B proceedings where the debtor could not meet the burden of proof upon it to show that it could be reorganized as a going concern, and under such circumstances such petitions were dismissed.

An illustrative case was *First National Bank v. Conway Road Estates Co.*, 94 F. (2d) 736 (CCA 8th, 1938), cert. den. 304 U. S. 578, 82 L. ed. 1541, 58 S. Ct. 1047, where the issue of good faith was passed upon prior to the submission of a plan of reorganization on motion by a lien holder to dissolve a temporary injunction restraining foreclosure. The language of the case is apposite here. It was said:

> "In a reorganization proceeding under section 77B good faith means more than honesty of purpose. It also

requires that there be a reasonable possibility of successful reorganization. Wright v. Vinton Branch Bank, 300 U. S. 440, 463, 57 S. Ct. 556, 562, 81 L. Ed. 736; Tennessee Publishing Co. v. American Bank, supra; In re. Tennessee Publishing Co., 6 Cir., 81 F. 2d 463; In re Loeb Apartments, 7 Cir., 89 F. 2d 431; Manati Sugar Co. v. Mock, 2 Cir., 75 F. 2d 284; O'Connor v. Mills, 8 Cir., 90 F. 2d 665; Provident Ins. Co. v. University Church, 9 Cir., 90 F. 2d 992.

"Whenever want of good faith appears the debtor's petition should be dismissed even though a plan of reorganization has not been submitted. The District Court was reversed for failure to dismiss in such a case in Provident Ins. Co. v. University Church, supra, in Re Wisun & Golub, 2 Cir., 84 F. 2d 1, and in Re North Kenmore Corporation, 7 Cir., 81 F. 2d 656. The judgment of the District Court dismissing the petition for want of good faith was affirmed in O'Connor v. Mills, supra; in Manati Sugar Co. v. Mock; supra; and in Re Gribsby-Grunow Co., 7 Cir., 77 F. 2d 200.

"In Brockett v. Winkle Terra Cotta Co., 8 Cir., 81 F. 2d 949, 953, Judge Valkenburgh, speaking for this court, said in reference to section 77B: 'The outstanding purpose of the Amended Act, upon which this case rests, was to afford aid in the effort to rehabilitate corporations solvent in fact but unable to meet maturing obligations.' It was not the purpose to lend its aid generally and without discrimination to corporations hopelessly insolvent, and without legal resources to prosecute their business with reasonable prospect of success.

"Considering the act itself and all these decisions it is apparent that it is the duty of the District Court to bear in mind the purpose and function of 77B at every step of the proceedings; and whenever it appears that

rehabilitation of the debtor is impracticable or that injunctive relief is not sought in good faith the court in the exercise of a sound discretion should refuse the debtor further aid in harassing lienholders. * * *" (94 F. (2d) 739)

Other cases similarly decided under Section 77B, in addition to those cited in the above case, are:

*Price v. Spokane Silver and Lead Co.*, 97 F. (2d) 237 (CCA 8th, 1938); cert. den. 305 U. S. 626, 83 L. ed. 401, 59 S. Ct. 88;

*Sophian v. Congress Realty Co.*, 98 F. (2d) 499 (CCA 8th, 1938);

*Milwaukee Postal Bldg. Corp. v. McCann*, 95 F. (2d) 948, 950 (CCA 8th, 1938);

*Sartorius v. Bardo*, 95 F. (2d) 387 (CCA 2d, 1938);

*In re Island Park Associates*, 77 F. (2d) 334, 337 (CCA 2d, 1935);

*In re Greyling Realty Co.*, 74 F. (2d) 734, 736 (CCA 2d, 1935);

*In re Prudence-Bonds Corp.*, 77 F. (2d) 328, 330 (CCA 2d, 1935);

*In re 235 West 46th Street Co.*, 74 F. (2d) 700 (CCA 2d, 1935);

and see:

*Old Fort Improvement Co. v. Lea*, 89 F. (2d) 286, 289 (CCA 4th, 1937);

48 Harvard Law Review 283.

And it seems clear that this court, as well, recognized the basic proposition that the sole purpose for which 77B pro-

ceedings might be maintained was to "rehabilitate" or "resuscitate" corporations as distinguished from the liquidation of their assets. It said in *City Bank Farmers Trust Co. v. Irving Trust Co.*, 299 U. S. 433, 81 L. ed. 324, 57 S. Ct. 292 (1937):

> "The purpose of § 77B was to facilitate rehabilitation of embarrassed corporations by a scaling or rearrangement of their obligations and shareholders' interests, thus avoiding a winding up, a sale of assets, and a distribution of the proceeds. * * *" (299 U. S. 438)

And in *Tennessee Publishing Co. v. American National Bank*, 299 U. S. 18, 81 L. ed. 13, 57 S. Ct. 85 (1936):

> "Nor do we need to inquire as to the precise limits of the concept of 'good faith' as required by sec. 77B. Whatever these limits may be, the statute clearly contemplates the submission of a plan of reorganization which admits of being confirmed as 'fair and equitable' and as 'feasible.' However honest in its efforts the debtor may be, and however sincere its motives, the District Court is not bound to clog its docket with visionary or impracticable schemes for resuscitation." (299 U. S. 22)

As said in *Marine Harbor Properties, Inc. v. Manufacturer's Trust Co.*, —— U. S. ——, 87 L. ed. (adv.) 73; 63 S. Ct. 93 (Nov. 9, 1942):

> "* * * Section 146 [of Chapter X] represents a codification of some of the interpretations which the courts had given the words 'good faith' in proceedings under sec. 77B. S. Rep. No. 1916, 75th Cong., 3rd Sess., p. 27. * * *" (87 L. ed. (adv.) 75)

That such codification of prior interpretations of the good faith provisions of Section 77B was made in the light of the cases cited thereunder to which we have just referred, and similar cases, is clear from the statements made at hearings held before the Committee on the Judiciary of the House of Representatives from June 1 to June 9, 1937, inclusive. Mr. Weinstein, member of the National Bankruptcy Conference, in explaining the definition of "good faith" in Chapter X, said in part (p. 140 of Hearing before the Committee on the Judiciary, House of Representatives, 75th Cong., 1st Sess., on H. R. 6439):

> "Now, as I indicated a while ago in connection with the approval of the petition, we have carefully defined the meaning of the phrase 'good faith' that is not defined in 77B. It may be anything that the judge says it means, and there have been decisions and there have been variances, and in some instances they are conflicting. One court has set up one standard and another court set up another standard. We have correlated these decisions and have taken out of the decisions what we believe to be the proper standards for determining good faith in the filing of the petition. We have also related good faith to what we tried to do in II, in respect to keep[ing] out companies that have no place in II, that ought to go under subsection I. I have read the definition of good faith and will not tire the committee by repeating it."

The date of Senate Report No. 1916, 75th Congress, Third Session, referred to in the *Marine Harbor Properties* case was April 20, 1938 and is obviously similar in substance to the statements of Mr. Weinstein previously made in June, 1937 at the House Judiciary Committee hearing.

Cases decided under Chapter X involving subsec. (3)

of Section 146 consequently hold that petitions for reorganization must be dismissed where the debtor cannot meet the burden of proof upon it to show that the corporation can be reorganized as a going concern.

*In re Julius Roehrs Co.*, 115 F. (2d) 723 (CCA 3rd, 1940);

*In re Suburban Properties, Inc.*, 110 F. (2d) 438 (CCA 7th, 1940);

*Chapman Bros. Co. v. Security-First Nat. Bank*, 111 F. (2d) 86 (CCA 9th, 1940);

*San Francisco Laundry Ass'n v. American Trust Co.*, 127 F. (2d) 187 (CCA 9th, 1942);

*In re Ware Metal Products, Inc.*, 42 F. Supp. 538 (D. C. Mass., 1941).

We had not thought the proposition open to doubt that unless the debtor could show that it was reasonable to believe that it could be rehabilitated as a going concern, the petition should be dismissed. The debtor's petition was filed with the declared purpose of having its obligations reduced to a point where it would be solvent and could again continue its business. All of its proof adduced at the hearing was directed toward attempting to show that it could again resume business. During the hearings, however, it became evident to all that Fidelity could never again be a going concern. The Circuit Court of Appeals expressly found and the District Court, as may be fairly inferred from its opinion, was also of the opinion that there was no reasonable prospect of the company being reorganized as a going concern. As stated by the Circuit Court of Appeals, there is "only the immediate need of a liquidation

of the company's assets for the benefit of the contract holders" (R. 259).

Under the authorities which we have cited such a situation required dismissal of the petition. After the hearings, however, it began to be suggested, particularly by the SEC and the federal trustee, that the federal proceedings should continue for the purpose of effecting what was termed a "slow and orderly liquidation," although no testimony had been adduced by any party to show the need for or the desirability of any such procedure. The District Court accepted that view and, insofar as its opinion is referable to Section 146 (3), apparently based its decision on the proposition which it expressed as follows:

> "It is not necessary that there be a reasonable prospect for the successful rehabilitation of the Debtor as a going or continuing corporation. It is sufficient if it is shown that the Debtor is in a position to conform to and obtain the benefits of the statute for a slow, beneficial and orderly liquidation. *R. L. Witters Associates, Inc. v. Ebsary Gypsum Co., Inc., et al.*, 93 F. (2d) 746 (C. C. A. 5th 1938); *Re Central Funding Corporation*, 75 F. (2d) 256 (C. C. A. 2d 1935); *In Re: Mortgage Securities Corporation*, 75 F. (2d) 261 (C. C. A. 2d 1935). * * *." (R. 196)

It is our view that this proposition is wholly erroneous as applied to the facts of this case. Such a construction of subsec. (3) of Section 146 of Chapter X results, under the facts here present, in its complete abrogation. It is difficult to see how a petition for reorganization could ever be dismissed by a creditor or other party in interest on the grounds specified in Section 146 (3), if all a debtor is required to show in order to suspend prior proceedings and

to initiate federal reorganization proceedings is that the assets of the corporation could be liquidated in a "slow and orderly" fashion. This could be done with any assets of any corporation, whatever the circumstances, and the protection afforded creditors by Section 146 would be a mere illusion.

We will analyze the cases cited in the District Court's opinion: In *R. L. Witters Associates v. Ebsary Gypsum Company*, 93 F. (2d) 746 (CCA 5th, 1938), which arose under Section 77B, the District Court had said, among other things.

> "By reference to 'good faith' the meaning is not merely sincerity of intention. The expression embraces a reasonable expectation of continued useful existence. There must be reasonable prospect for successful rehabilitation of the debtor * * *
>
> "Undoubtedly section 77B is aimed at the 'continuance of a business as a going concern,' and does not contemplate an inactive corporation, bereft of its chief means of livelihood. * * *
>
> "Where a case presented is one for liquidation or for composition, proceedings under 77B should not be approved and the rights of creditors must be guarded and recognized throughout the proceedings as paramount to those of stockholders. * * *" (93 F. (2d) 747)

(We may note that language substantially similar to the foregoing was expressly approved in *Case v. Los Angeles Lumber Products Co.*, as cited *ante* at page 100.)

The Circuit Court of Appeals said of this:

> "Appellant insists that the District Judge gave too narrow a construction to the statutory words 'good

faith'; that he gave them a meaning not intended by the lawmakers, and neither expressed nor implicit in the words. It insists that this ruling would exclude from the operation of the statute all corporations except those which are to be reorganized as going concerns; that specifically it would exclude corporations seeking an orderly and conserving liquidation as against the disrupting and dismembering processes of common-law actions and seizures.

"We agree with appellant. The statute as to the corporations eligible to file the petition is broad and comprehensive. Under it, 'Any corporation which could become a bankrupt * * * may file an original petition.' *Nowhere in the statute is there any definition of 'good faith.'* What is meant by the term must be drawn from the meaning of the words themselves; as interpreted by the context in which they are used; the purpose back of the statute, the mischiefs it was enacted to prevent, the results it was enacted to accomplish." (Emphasis supplied) (93 F. (2d) 748)

Judging from this language the Circuit Court of Appeals for the Fifth Circuit apparently adopted the theory that under certain circumstances a corporation might petition for reorganization on the ground that it sought an orderly and conserving liquidation of its assets. Under the numerous decisions which we have cited we believe that it is highly doubtful whether such a construction of the act could be maintained as a broad proposition. The lower court's opinion in the *Witters* case is certainly in line with the authorities to which we have referred. The Circuit Court of Appeals' decision was handed down January 5, 1938 and appears, from the language above quoted, to have been predicated upon the fact that Section 77B contained

no definition of good faith. We have seen, however, that Chapter X does contain an explicit definition of good faith and that as early as June, 1937 at the House Judiciary Committee hearing thereon this definition was stated to be the result of the correlation of previous decisions of the courts on the good faith question. Chapter X became effective June 22, 1938 and there can be no question but that in its enactment Congress intended to adopt the decisions rendered prior to the Circuit Court of Appeals' decision in the *Witters* case. The District Court's opinion in the *Witters* case (19 F. Supp. 648) was handed down June 16, 1937 and the cases relied upon therein must obviously have been the same cases which Congress had in mind in adopting the specific definition of good faith found in Chapter X.

Assuming for the purpose of argument that, as possibly decided in the Circuit Court of Appeals' decision in the *Witters* case, a petition for reorganization could be approved solely on the ground that the debtor sought an orderly and conserving liquidation of its assets, it seems too clear for argument that such a theory of reorganization, if valid at all, must be limited to cases where the debtor can make some showing of "going concern value."

Examination of the opinion of the District Court in the *Witters* case, *In re Witters Associates, Inc.*, 19 F. Supp. 648 (D. C. S. D. Fla., 1937), reveals that prior to the petition for reorganization being filed the debtor had sold all of its property to a corporation known as Cement Sales, Inc. under common control with it, which latter corporation proposed to go into the business of importing foreign cement. The property sold consisted of a warehouse and dock which had cost about $49,000, and was subject to mortgages of approximately $28,000, which mortgages had been assumed

by Cement Sales, Inc. The remainder of the purchase price was the sum of $21,500 to be paid by Cement Sales, Inc. in monthly installments of $200.00 each. The only basis upon which the Circuit Court of Appeals decision could be approved would be, as we see it, on the theory that it had reason to believe that the operation of the business of Cement Sales, Inc., the purchasing corporation, would enable it to pay off the mortgages and also pay for the equity of the debtor company, which equity amounted to approximately $21,500.

The situation there was vastly different from that of Fidelity Assurance Association in this case. Here the debtor has no equity whatever remaining in any of its assets, proceedings had already been commenced for the purpose of liquidating those assets prior to the filing of the petition, and going concern values of any kind are entirely absent.

The case of *In re Julius Roehrs Co.*, 115 F. (2d) 723 (CCA 3rd, 1940), is of particular interest in this regard. There the District Court had dismissed a petition filed under Chapter X as not filed in good faith. In deciding on the good faith question the District Court had required that the debtor file a tentative plan of reorganization and there was general testimony of one of the officers of the debtor as to why it was believed reorganization would be possible and advantageous. The Circuit Court of Appeals in remanding the case to the District Court for further proceedings, said:

> "* * * that it was not the duty of the court to ascertain whether or not a particular plan of reorganization could be carried out but only whether it was reasonable to expect that a plan of reorganization could be effected; that there was opportunity and need for reorganization and that the petition was filed with the

honest intention of effecting it and not for the purpose of hindering and delaying creditors. R. L. Witters Associates v. Ebsary Gypsum Co., Inc., 5 Cir., 93 F. 2d 746; Snyder v. Fenner, 3 Cir., 101 F. 2d 736. Nor is the test whether stockholders will profit by reorganization. It may well be that a plan ultimately adopted would exclude stockholders from any participation. Case v. Los Angeles Lumber Products Co., Ltd., 308 U. S. 106, 131, 60 S. Ct. 1, 84 L. Ed. 110; In re Central Funding Corp., 2 Cir., 75 F. 2d 256, 261. *There is always a question as to whether or not there is a good will or going concern value in the business of a debtor which feasibly may be preserved by reorganization for those entitled to it.* But, as we have already indicated, the petition may not be found to be filed in good faith if it is within any of the prohibitions set forth by Section 146, though it must also be borne in mind that the generality of the meaning of the term 'good faith' is not to be limited by the specific provisions of the section. These are the questions that the District Court must pass on." (Emphasis supplied) (115 F. (2d) 724)

The cases cited by the District Court in the present case cannot, we believe, go beyond the scope of this language.

The case of *Re Central Funding Corp.*, 75 F. (2d) 256 (CCA 2d, 1935), has little, if any, application here. The question of good faith was in no way involved, discussed or decided there. No party had challenged the debtor's good faith. The case involved an appeal from an order confirming a plan of reorganization entered in the lower court. Ninety-four per cent of the debtor's security holders had consented to the plan and only an indenture trustee appealed from the order. The only issue was whether the plan adopted was a plan of reorganization within the mean-

ing of Section 77B (b) (11 U. S. C. A., sec. 207 (b)), (which provisions are similar to those of Section 216 of Chapter X). The opinion does not disclose the factual situation in sufficient detail so that we are able to determine what the decision would have been on the issue of good faith, had such issue been raised. From the language of the court we may deduce that there was some proof in the case which would indicate that the continuance of the business for liquidating purposes only (which apparently had been its only previous function) would produce more for the creditors than a more speedy liquidation. The court did point out:

> "* * * The plan here does not recognize an equity which is of no value, and it arranges simply for the carrying on of the same business conducted by the Central Funding Corporation for a long enough period to enable the new corporation to liquidate advantageously the collateral that secured the bonds that were issued by the debtor. * * *" (75 F. (2d), 259)

Assuming such a case to have a bearing upon the construction of the good faith provisions of Chapter X, it is readily seen that the facts in this case are radically different. Here creditors and others have challenged the debtor's good faith, proceedings have been commenced for the liquidation of Fidelity's assets for their benefit in proceedings expressly adapted to such purpose, and there is no proof whatever that there are any going concern values to be preserved for creditors by a plan of "slow liquidation" which might conceivably be worked out.

*In re Mortgage Securities Corporation*, 75 F. (2d) 261 (CCA 2d, 1935), is a companion case to the *Central Funding* case and the facts are the same. The question of good faith

was not raised in the case nor touched upon in the short opinion.

The other cases relied upon by appellants, such as *In re Porto Rican American Tobacco Co.*, 112 F. (2d) 655 (CCA 2d, 1940), and *Continental Ins. Co. v. Louisiana Oil Refining Corp.*, 89 F. (2d) 333 (CCA 5th, 1937), are not helpful on the issue of good faith as presented in this case. The issue of good faith was not raised nor in any way decided or commented on in either of these cases. We note that in the *Porto Rican American Tobacco Co.* case the plan apparently contemplated that going concern value would be realized upon by a sale of all of the assets of a subsidiary corporation of debtor to a competing corporation which would operate the same and issue its securities to the debtor's creditors. The *Louisiana Oil Refining* case is cited in the *Porto Rican American Tobacco Co.* case, and while the issue of good faith was in no way raised in the *Louisiana Oil Refining* case, we note that the plan under discussion provided for the continued operation of the business of the debtor by another concern with which it would merge. Such cases are of no assistance here, where the business in which the debtor formally engaged is not to be carried on again but all that remains to be done is to liquidate assets consisting entirely of negotiable securities held in trust by various state authorities to secure contract holders therein. Obviously such procedure would not constitute the reorganization of the business of Fidelity Assurance Association as the term "reorganization" must be interpreted as used in subsec. (3) of Section 146.

That there is a distinction between the cases to which we have referred where the issue of good faith was not raised, and the case at hand where the issue was raised, is

demonstrated by *Sophian v. Congress Realty Co.*, 98 F. (2d) 499 (CCA 8th, 1938). No issue of good faith was raised in that case. The court reviewed a plan of reorganization adopted in the District Court, refused to confirm it, remanded the case for further proceedings and, in so doing, said:

> "The petition of this debtor for reorganization should probably have been dismissed on the ground that it was not filed in good faith. Price v. Spokane, Silver & Lead Co., supra, at page 247. The appellants, however, have not asked that that be done. It is possible that in these proceedings some plan can be worked out which will give to the bondholders all that they are entitled to and will secure the elimination of the valueless stock interest." (98 F. (2d) 502)

It seems too clear for argument that Chapter X was not intended as a mode of liquidating insolvent companies. As said in *Securities and Exchange Commission v. United States R. & Imp. Co.*, 310 U. S. 434, 84 L. ed. 1293, 60 S. Ct. 1044 (1940), where liquidation is indicated, a petition for reorganization must be dismissed *"leaving the debtor to the alternative remedy of bankruptcy liquidation"* (310 U. S. 457).

**b. Neither the petition nor the proofs thereon show that debtor is entitled to the benefits of Chapter X; in fact, the contrary is shown**

**The Petition**

The obvious purpose of debtor's petition as filed was to rehabilitate it as a going concern. The proofs adduced by the debtor were directed to showing that it could be rehabilitated as a going concern. When such proofs utterly failed, the SEC and the federal trustee introduced the idea of "slow liquidation" as reorganization, as discussed above. It is obvious from the petition that the debtor is proceeding on a wholly erroneous theory of what may be accomplished in a Chapter X proceeding, even though it did recognize at the outset that the purpose of the proceeding was to enable it to be rehabilitated and continue as a going concern. Paragraph VII of the petition (R. 7-8) reads:

> "Debtor further states that it now has outstanding investment and annuity contracts with reserve liabilities totaling approximately $25,000,000, and that in these contracts debtor agrees to pay interest accumulations of from four to five percent per annum; that the decrease in interest rates in recent years has made it impossible for debtor to invest its funds in conformance with the West Virginia law and to earn the interest requirements as set forth in its said outstanding contracts; and that by reason of said interest requirements under its said contracts debtor is now suffering an annual loss of approximately $250,000 per annum, and that this loss will continue and probably increase unless the earnings on sound securities should increase far in excess of the present rate of income.
>
> "That for the reasons above set forth debtor has been unable to meet its obligations as they mature and will be unable to meet its obligations as they mature

unless the rights of its contract holders are modified so that the earnings received on securities and assets owned by debtor will be sufficient in amount to meet the requirements under its outstanding contracts; and if the rights of its outstanding contract holders are modified to this extent, debtor will be able to comply with the Investment Company Act of 1940 and will be enabled to resume the operation of its business.

"Debtor further states that each of its existing and outstanding contracts is secured under the terms of each of its said contracts by a reserve fund, which is on deposit with the Treasurer of the State of West Virginia and with the officials and departments of other states where the securities of debtor were sold; and that the rights of all contract holders must be modified as above set forth in order that debtor may be permitted to obtain adequate relief, and that by reason of these facts debtor cannot obtain adequate relief under chapter 11 of the Bankruptcy Act."

Debtor thus seeks to carve an equity for itself out of the assets which belong wholly to contract holders. This it cannot do.

*Marine Harbor Properties, Inc. v. Manufacturers Trust Co.*, —— U. S. ——, 87 L. ed. (adv.) 73, 63 S. Ct. 93 (Nov. 9, 1942);

*Case v. Los Angeles Lumber Products Co.*, 308 U. S. 106, 84 L. ed. 110, 60 S. Ct. 1 (1939);

*Northern Pacific Ry. v. Boyd*, 228 U. S. 482, 57 L. ed. 931, 33 S. Ct. 554 (1912);

and see

*Chapman Bros. Co. v. Security-First Nat. Bank*, 111 F. (2d) 86 (CCA 9th, 1940).

**The petition considered with reference to the state deposit laws**

In order to have a clear understanding of just what the debtor seeks to accomplish here we must consider the nature and operation of the state laws, particularly those providing for deposits.

Fidelity was strictly regulated in each state in which it operated. In fifteen of these states, including West Virginia, it had to maintain a deposit as a condition precedent to its obtaining a license to do business therein. The West Virginia deposit was made pursuant to sec. 3, Art. 9, Ch. 33, West Virginia Code.

This section provided that in order to be licensed in West Virginia a deposit in trust of one hundred thousand dollars, and additionally, an amount equal to the total cash liabilities of the company had to be made with the state. The deposit was to be made in securities subject to approval of the insurance commissioner. The deposit requirement was reduced to the extent that the company had securities on deposit elsewhere to secure its liabilities in accordance with the standards of the West Virginia law.

In Wisconsin by sec. 216.02, Wis. Stats. (dealing with "investment associations," App. 1) all of the provisions of Ch. 215 (which relates to the regulation of building and loan associations, App. 2-18) with respect to the supervision, control and conditions upon which foreign building and loan associations are permitted to do business there are made applicable to busiresses such as Fidelity's. By secs. 215.38, 215.39 and 215.395 (App. 3-4) it is provided that a deposit of specified securities shall be maintained as a condition precedent to being licensed to do business there "*in trust* for the benefit and security of all its members in this state", in such amount that the liabilities on

outstanding contracts shall not exceed 90% of the deposit. The deposit is to be held in trust until "all contracts and obligations to persons and members residing in this state shall have been fully performed and discharged." These building and loan association laws were applicable to Fidelity's business and to the deposit made in Wisconsin during all the time it operated there, and thereafter with respect to the liquidation of its Wisconsin assets. Sec. 215.33, Wis. Stats. (App. 8-18).

The laws of the states which require deposits are summarized in the opinion of the Circuit Court of Appeals (R. 241).

Most of these state laws contain detailed provisions for the liquidation of the deposit in the event of insolvency and all provide for the retention of the deposit by the state authority until all claims of residents have been paid in full. The amount of the deposits actually held by the various state authorities, and the liabilities appertaining thereto, is shown, according to debtor's figures, in Ex. 48 (R. 1116 (original)) and a schedule taken therefrom is set forth in the joint statement of facts (*ante*, p. 19).

Fidelity's contracts themselves uniformly contained a provision in Section 1 thereof that the company should maintain certain "reserves" and provided further that "the reserve fund less any unpaid portion of any loans made therefrom on such contracts and any uncollected interest shall be invested in approved securities and deposited in trust as required by the laws of the state of West Virginia" (Exs. 1, 2, 3, 4, 5; R. 170 (original)).

Thus it is seen that all of the contract holders are beneficiaries of state trust deposits, some under the West Virginia trust deposit alone, some under both the West Vir-

ginia trust deposit and the trust deposit in another state and some, such as those in Wisconsin and Iowa, under trust deposits in their own state.

The debtor has made no contention that these trusts are not valid as created and indeed could make no such contention. Such provisions are commonly found in state statutes providing for the regulation of *quasi*-public corporations such as Fidelity and are everywhere sustained as valid enactments. Such laws are discussed generally at 23 Am. Jur. 271 and at 23 Am. Jur. 467, where it is said:

> "* * * the corporation, as well as its stockholders and receiver, is estopped from disputing the validity of a trust upon which the corporation has deposited securities as a condition of the license to do business in the state. * * *"

And see: *United States v. Knott*, 298 U. S. 544, 80 L. ed. 1321, 56 S. Ct. 902 (1936);

*Blake v. McClung*, 172 U. S. 239, 43 L. ed. 432, 19 S. Ct. 165 (1898) (particularly at 172 U. S. 257);

*American United Life Ins. Co. v. Fischer*, 130 F. (2d) 643 (CCA 8th, 1942).

The validity of the Wisconsin deposit law (in an earlier form) with respect to deposits required of foreign building and loan associations (Fidelity was regulated as such under Wisconsin law during the time it operated there) has been fully sustained in Wisconsin. *Lewis v. American Savings & Loan Assoc.*, 98 Wis. 203, 73 N. W. 793 (1898).

According to Ex. 48 filed by the debtor (R. 1116 (original)), the market value of all securities on deposit under these laws with the State of West Virginia and with other

states was $20,056,680.27 on June 6, 1941, while the total "net cash liability" to contract holders for whose benefit these deposits were made was, according to that exhibit, $23,475,668.67 as of April 10, 1941. On these figures then, the various state trust deposits are, on a "net cash liability" basis, insufficient to meet Fidelity's present contract liability by a sum in excess of $3,400,000. If Fidelity were again to be licensed so as to continue to do business in the State of West Virginia or in any of these other states requiring deposits, it is clear not only that the present deposits could not be disturbed, but that additions thereto would have to be made in an amount in excess of $3,400,000. To remedy this situation Fidelity, according to the allegations of its petition for reorganization, proposes to reduce its liabilities on its contracts.

Apparently debtor would maintain that while it was necessary to meet the requirements of the state deposit laws in order for it to be licensed to do business in the states, yet as soon as its liabilities exceed those permitted by these laws, it can then, in order to prevent the state authorities from foreclosing on these funds for the benefit of the contract holders, obtain the aid of the federal court in reducing its liabilities to a point where the deposits would again be made whole. Aside from running afoul of the principles of the *Marine Harbor Properties*, the *Los Angeles Lumber Products* and other cases cited above, the sustaining of a petition for reorganization on such a showing would render the state deposit laws of no practical effect or value whatever. Presumably such corporations as the debtor might avoid the effect of the state laws upon which their licenses to do business depended by filing periodic petitions for reorganization in federal court whenever the

deposits might shrink to a value below the requirements of the state laws.

**The Proof**

Assuming that, despite the obvious deficiency of the petition within the principles and under the facts above discussed, the debtor could be permitted to establish its good faith at the hearing on the controversial answers, if has wholly failed to do so. The burden of proof is of course upon the debtor to establish its good faith in the proceedings, particularly when expressly challenged thereon.

*Marine Harbor Properties, Inc. v. Manufacturer's Trust Co.*, —— U. S. ——, 87 L. ed. (adv.) 73, 63 S. Ct. 93 (1942);

*In re Cook*, 104 F. (2d) 981 (CCA 7th, 1939);

*Hickey v. Ritz Carlton*, 96 F. (2d) 748 (CCA 3rd, 1938);

*Manati Sugar Co. v. Mock*, 75 F. (2d) 284 (CCA 2d, 1935);

*In re Scheney Brothers*, 12 F. Supp. 609 (D. C. Conn., 1935).

The debtor utterly failed to sustain the burden of proof which is upon it to show, in accordance with Section 146-(3), that it is reasonable to expect that it can be reorganized. It will be recalled that debtor is completely insolvent to the extent of at least three or four million dollars, that it has no license to do business in any state, that it completely suspended the sale of annuity contracts prior to December 31, 1940, that all of its offices have long since been closed, its sales force completely dissipated and lost, and that it is without good will of any sort.

No witness produced by the debtor was able to give the slightest hint as to the manner in which a reorganization could be effected.

John Marshall, Sr., former chairman of the Board, voting trustee, and one of the individuals dominant in the filing of the petition, stated that "I have not any idea of the plan, have not worked on the plan, and don't feel that I am competent to work on it. I have hoped some plan could be worked out" (R. 420), and that "I would not even sit here as a witness and say a plan could be promulgated" (R. 420); "How it is going to be done, I cannot say; I simply don't know" (R. 429).

Mr. McNulty, the debtor's vice president, stated that "There should be additional and new money" (R. 336). He had "not gone into the point of developing any plan" (R. 343). He stated he was a stockholder, had been with the company since 1922, felt attached and devoted to it and "just hopes there is some way to reorganize" (R. 343).

According to Auditor Sims, "The structure of the company economically and financially was unsound from the beginning" (R. 454).

Allen G. Messick, the most recent chairman of the Board, stated that he had been working on the proposition for a year and a half (R. 561). He thought that "a company can be founded on compulsory savings and yield a safe return" (R. 557). He had considered a plan to segregate everything into funds, telling the contract holders what they had, and then "frankly putting it up to them and having them write it down on a relisted basis" (R. 559). He conceded that where contract holders in some states were secured to the full extent of their contracts by deposits, even such a voluntary plan as he proposed would necessarily fail (R. 559).

D. A. Burt, one of the directors, stated that "the first thing of course is to get a plan of such character that new capital can be obtained" (R. 708), but that he did not know whether the company should be continued as a face amount certificate company or in some other form or a combination of more than one form of business (R. 709). He refused to discuss any possible plan, stating, "You are trying to get me to discuss the plan which I will not discuss" (R. 721). In stating that he thought the company could be reorganized he had not considered the authorities of the twenty-nine states in which the company had been licensed (R. 724). He didn't know the basis on which the contracts had been sold in the various states because "we had a regularly organized company to look after those sales" (R. 726).

Carroll D. Evans, formerly a member of the Board and director of sales since 1935, stated that, having in mind the best interests of the contract holders, he could not answer the question as to whether the company should be liquidated or reorganized (R. 933).

The most conclusive testimony to the effect that it is utterly hopeless to expect that Fidelity could succeed either in the sale of annuity or insurance contracts in the future is that of Henry M. Steussy who, during the time Fidelity operated in Wisconsin, was in charge of its operations there.

Mr. Steussy testified that after he left Fidelity he became vice president of Franklin Life Insurance Company. That company, a large and well established concern, had instituted a program whereby a face amount certificate "reconstructed just as the Fidelity contract would have to be reconstructed if the Fidelity Assurance Association was going to operate as an insurance corporation" (R. 1024) was to be sold by that company. It had been qualified for sale

by Franklin in eighteen states (R. 1016). When he had been in charge of Fidelity's Wisconsin operations that office ranked in the top position of all of Fidelity's offices with respect to its sales record (R. 1011). When placed in charge of this program for Franklin he took with him only his best Fidelity salesmen, those who had been able to sell even after the SEC investigation (R. 1026). Franklin had given special training to a group who specialized in selling the annuity type policy for it (R. 1025). The program proved to be a complete failure, however, and these salesmen were unable to sell a sufficient volume of the new Franklin contracts to stay in the business (R. 1026).

Based upon his experience both in Fidelity and in the Franklin Life Insurance Company, he stated that the company could not be reorganized on the seven per cent loading charge permitted by the Investment Company Act of 1940 and could not possibly load the contracts so that it could assemble a sales force and be successful in selling (R. 1039-1040). He stated that Fidelity could not be qualified with the insurance departments in most states of the union (R. 1040).

The competition in the field of savings created by the sale of defense bonds was also shown to make the prospect of future success remote (R. 1043-1046). In view of the fact that government defense bonds may be purchased on monthly payments with the purchaser receiving monthly notices and that the yield is 2.9% (higher than the yield on most of the Fidelity contracts sold since 1934) it is not difficult to see why Fidelity could not hope to meet this competition and the testimony is clear that it could not.

Counsel for the SEC expressly conceded in the Circuit Court of Appeals that the possibilities were "practically

100%" against Fidelity being reorganized as a going concern, and do not argue here that it may be so reorganized. However, the petitioners (the debtor and the trustee) still appear at this late date to be attempting to show that Fidelity can be reorganized as a going concern. In their brief (pp. 44-46) they refer to the testimony of certain witnesses who made statements to the effect that they thought Fidelity could be reorganized. These witnesses specifically refused to venture the slightest suggestion as to how a reorganization might be accomplished or made suggestions so vague as to be entirely without practical meaning. Some of them, as we have shown, testified positively that debtor could not be reorganized. And see testimony of D. A. Burt, R. 715, 718-721, 724, 726, 727; Hubert F. Young, R. 631; Edgar B. Sims, R. 457; H. Isaiah Smith, R. 480, 481, 482, 483; Allen Messick, R. 559-560; Raymond Latta, R. 1111, *et seq.*

"Pell, Ltd." referred to at p. 45 of petitioners' brief, was merely an association of financial men in New York who evinced some interest in purchasing the stock of Fidel Association of New York, a subsidiary of Fidelity, and expressly stated they would make no promises with respect to reorganizing Fidelity (R. 1226). The vague suggestions made in petitioners' brief that Fidelity might be merged with some other investment or insurance company fall far short of meeting the burden of proof on the debtor to show that it can be reorganized.

The District Court made no finding whatever as to whether or not it was unreasonable to expect that a plan of reorganization could be effected. In its opinion it said:

> "* * * It is true that the broad picture developed by the testimony at the hearing does not present a very

favorable view with respect to the rehabilitation and continued operation of the Debtor as a face amount certificate company. * * *" (R. 194-195)

The proponents of the petition were all agreed that any hope of continuance as a going concern would be as a life insurance company (see respondents' joint statement of facts, p. 48-51 *ante*). Assuming for the purpose of argument that debtor was not a life insurance company on the day the petition was filed, it seems obvious that it could not reorganize itself as such under Chapter X.

The District Court further said (R. 195):

> "* * * It is extremely doubtful whether, in view of unsettled economic conditions and the critical international situation, the Fidelity plan would any longer appeal to a large public; *but it is not impossible;* and it is not the duty of the court to decide for the public that investors will not or should not buy these contracts in the future." (Emphasis supplied)

Under the District Court's own interpretation of the testimony, dismissal is unquestionably required under the authorities which we have discussed above. The District Court's opinion (R. 195-196) contains certain statements bearing upon its conclusion that it was "not impossible" for the debtor to resume business. It was said that "the fact that the company has not been operated profitably in the past is not shown to be the result of financial unsoundness in the plan itself." But such statement is completely disproved by the record, particularly the SEC report comprising Ex. 6.

The District Court further stated that it was unsoundness in management methods and extravagant sales and

promotion expenses, useless expenditures for lavish offices including the home office building in Wheeling, West Virginia, and over-expansion particularly in states like Wisconsin where the strictness of regulatory laws made it impossible to operate at a profit, that brought about the company's failure to operate profitably. We do not dispute that these things contributed to its downfall, but nevertheless it was conclusively shown that it was only by these so-called "high-pressure" sales methods that the company could sell its contracts in sufficient volume to continue in business (R. 924).

The District Court stated that the requirements of the Investment Company Act of 1940 were calculated to make the contracts more salable and that this regulatory law has not had the effect of banishing such companies from commercial operation. However, each and every officer of the debtor who testified, and also its general attorney, stated unequivocally that the company could not operate under the Investment Company Act of 1940. And the chief reason for the re-chartering of the company as an insurance company on December 31, 1940 was that the company recognized it was impossible to operate under that Act. The District Court also stated that the testimony discloses that at least one other such company is still in operation "presumably with some measure of success." We take it that by this statement the court referred to the "Investors' Syndicate," a company which operated on the same basis as Fidelity and which was mentioned several times in the testimony. But diligent search of the record on our part does not reveal the economic situation of Investors' Syndicate. The testimony shows that that company some time ago was negotiating with a certain "Chicago Corporation" with

a view to refinancing, and that these negotiations apparently did not succeed (R. 1141). Mr. Pulfer, Fidelity's sales manager in Illinois, testified that he "understood" Investors' Syndicate was still engaged in business and "understood they had a very nice business last year." This is of course the purest hearsay and could form no basis whatever for a conclusion that Investors' Syndicate was operating profitably either in the past or at present. Hubert F. Young, who had charge of Fidelity's investment portfolio, testified that he "understood" that Investors' Syndicate had recently incorporated a new company under the Investment Company Act of 1940, but he stated that he had "no idea" whether that company was now doing business in West Virginia, Wisconsin, Illinois, Tennessee and other states (R. 677). H. Isaiah Smith, one of the West Virginia state court receivers, presently employed by the federal trustee, stated that he did not know whether the Investors' Syndicate was selling face amount certificates today (R. 511). The District Court then remarked that it did not see where the situation of Investors' Syndicate was material because "we may form a new company of Fidelity before we are through with it" (R. 511). We find no other reference to that company anywhere in the record. Neither the SEC, who presumably would have full information as to the operation of Investors' Syndicate under the Investment Company Act of 1940 and previously, nor the debtor, made any attempt whatever to demonstrate that that company, either in its past character or as a new company, had operated or was operating with any degree of success. We refer to the SEC report, Ex. 6, for a discussion of the affairs of Investors' Syndicate.

With respect to all of the unfavorable publicity which Fidelity has received, the District Court stated that all this

had been directed to the unreorganized company and that "it does not follow that if and when the company may be reorganized under the supervision of a United States court, it would retain any of the stigmata which it is the purpose of such reorganization to remove." In view of the undisputed facts as to the effect of this publicity, we can hardly agree with this.

The District Court disposed of the argument that the several states where the debtor had sold its contracts might be unfriendly to future operations of the reorganized company therein by stating "it is sufficient to say that this argument imputes to the governments of those states unworthy motives for future action—motives which no court should assume would be entertained." The District Court wholly failed to consider the nature and effect of the various state laws upon Fidelity's operations, apparently being of the opinion that no discretion whatever resided in state officials as to whether or not the "Fidelity plan" would again be acceptable to those states. The difficulties to be faced may be illustrated by examination of cases in which former efforts of state authorities to ban Fidelity and similar companies are shown.

In *Investors' Syndicate v. Bryan*, 113 Neb. 816, 205 N. W. 294 (1925), affirmed in memorandum opinion by this court, at 274 U. S. 718, 71 L. ed. 1322, 47 S. Ct. 590, the action of the administrative authorities of the state of Nebraska was sustained in denying that company a license to operate there on the basis that the contracts were unfair, unjust and inequitable.

In *Investors' Syndicate v. Porter*, 52 F. (2d) 189 (D. C. Mont., 1931), that company sought to enjoin enforcement of an order of the Auditor and Ex-officio Investment Com-

missioner of Montana, which had revoked the company's license to sell unless the lapsation and other penalties were modified. A three judge district court granted the injunction on the ground that the Montana statute did not give due process. This holding was reversed in *Porter v. Investors' Syndicate*, 286 U. S. 461, 76 L. ed. 1226, 52 S. Ct. 617. In view of the reversal of the district court's judgment, the dissent of one of the district judges is interesting. It provides a complete answer to the contention that the states do not have power under existing law to bar contracts containing such "forfeiture" and "loading" as those involved here on the ground that they are inequitable and unfair to investors.

In *Fidelity Investment Ass'n v. Emerson*, 318 Ill. 548, 149 N. E. 530 (1925), the Secretary of State of Illinois had cancelled Fidelity's license to do business there because the contracts "would work or tend to work fraud upon the purchasers" within the meaning of the Illinois Security Law. Two lower appellate courts sustained the order and it was set aside in the Illinois Supreme Court which found in substance that since the forfeitures were set forth in the contract the contracts could not be said to be fraudulent on their face. The court left open the question as to whether the order might have been sustained if it had been based upon the selling methods used.

We may say that the securities law of Wisconsin, Chapter 189, under which Fidelity's contracts would have to be registered if they were again to be sold there, gives the Securities Department there broad discretion to deny registration if the plan of operation "tends to be unfair, inequitable or fraudulent, or against public interest or the interest of investors." (Sec. 189.13, Wis. Stats. 1941; App.

18-20). The Iowa Securities Act contains similar provisions. (Ch. 393.1, App. 41-50; and Ch. 392 Code of Iowa, App. 37-40). The regulatory laws of other states contain like provisions, and while no state authority could state by way of pre-judgment that Fidelity would not again be admitted there, a realistic appraisal of the situation leads inevitably to the conclusion that, now that the manner in which the "Fidelity plan" operated has been fully disclosed, including the fact that 95% of the investors therein did not carry the contracts to maturity and sustained a net loss upon their investment, such state laws and regulatory authorities would not permit the operation of this type of "plan" again.

**C. Prior proceedings are pending which will best subserve the interests of contract holders**

The Circuit Court of Appeals held that the petition was not filed in good faith within the meaning of Section 146 (4) of Chapter X, which provides that a petition shall not be deemed to be filed in good faith if a prior proceeding is pending in any court and it appears that the interests of creditors and stockholders would be best subserved in such prior proceeding. This decision was, of course, arrived at in the light of the complete record on file with the court.

In *Marine Harbor Properties, Inc. v. Manufacturer's Trust Co.*, —— U. S. ——, 87 L. ed. (adv.) 73, 63 S. Ct. 93 (Nov. 9, 1942), it is said, in discussing the history and proper interpretation of Section 146 (4) of Chapter X:

> "In view of that history it seems clear that when a prior proceeding is pending, a petitioner's showing of 'need for relief' under Ch. X, required to be con-

tained in every petition by the express provisions of § 130 (7), must demonstrate that at least in some substantial particular the prior proceedings withhold or deny creditors or stockholders profits, advantages, or protection which Ch. X affords. In absence of such a showing the 'need for relief' has not been established and the District Court is not enabled to make an informed judgment on the 'good faith' issue." (87 L. ed. (adv.) 76)

The debtor did not make nor attempt to make, either in its petition or proof, any showing that the prior proceedings pending in the state courts would deny creditors benefits, advantages or protection which Chapter X affords. The petition merely stated that the debtor could not resume business unless its contracts were modified. It thus shows on its face that there is no equity remaining for the stockholders in the assets of the company. The petition recites that certain state court proceedings are pending, but it makes no suggestion that such proceedings are not adequate for the protection of creditors. In fact, it does not even suggest that the proceedings are brought for their benefit.

In arriving at a conclusion under Section 146 (4) of Chapter X the only question involved is whether or not the prior proceedings best subserve the interests of the creditors in this case, the contract holders. Aside from the fact that the debtor wholly failed to make any showing that the prior proceedings would not best subserve the interests of contract holders, the facts as analyzed by the Circuit Court of Appeals show conclusively that the prior proceedings will in fact best subserve the interests of contract holders.

**The Wisconsin proceedings**

We have previously in this brief set forth the nature of the laws providing for the licensing and supervision of Fidelity and the liquidation of its assets in Wisconsin (*ante*, p. 51-55). The proceedings there were instituted under a complete and detailed scheme providing for the realization of the claims of Wisconsin contract holders out of the assets deposited in Wisconsin. Prior to the filing of the federal petition the Wisconsin contract holders had filed their claims, including the contracts themselves, in the Wisconsin proceedings (Ex. 114, R. 3546 (original), App. 27-36). The Wisconsin contract holders have always looked to and still look to the Banking Commission of Wisconsin to secure to them their proper share of the funds on deposit there. There are some 6000 "active" contract holders in Wisconsin with a total "net cash liability" of approximately $2,340,000. The average "net cash liability" to each of these contract holders is thus between three and four hundred dollars. They purchased the contracts on express representations made to them by debtor as to the security provided by the Wisconsin deposit law. The settlement of any questions arising as to the relative rights of such contract holders in the Wisconsin deposit is amply provided for. It seems almost idle to suggest that the interests of Wisconsin contract holders would be better subserved if each of them is thrown on his own resources and required to employ counsel to prosecute a claim against the Wisconsin deposit in the far-off District Court for the Southern District of West Virginia.

The attitude of the Wisconsin contract holders has been clearly expressed. With singular unanimity they are desirous of severing for once and all their relationship with

Fidelity Assurance Association. Their desire is to have the funds deposited in Wisconsin applied to the just settlement of their claims in an expeditious manner. They are wholly uninterested in reorganization or liquidation plans which may be formulated in the District Court for the Southern District of West Virginia. Their sentiments are expressed in the affidavits of Howard L. Smith and Emmett G. Hampton admitted in evidence here under stipulation as to matters of fact which they contain (R. 3546 (original)), which affidavits comprise Ex. 114 printed at pp. 27 to 36 of the Appendix hereto.

The proceedings pending in Wisconsin are conducted entirely by public authorities under the supervision of a state court, and no liquidator's fees for this service are to be exacted out of the securities deposited there. Counsel for the Banking Commission of Wisconsin in these proceedings have been and are being provided by the Attorney General of Wisconsin at no cost to the contract holders. Prior to the commencement of the federal proceedings and on May 27, 1941, securities comprising a part of the Wisconsin deposit were liquidated and sold, whereby the sum of $1,259,244.04 was realized (Ex. 120, R. 3803 (original)). The prices obtained were substantially in excess of the par value of the securities sold and we have not heard the slightest suggestion that this sale was not conducted in a manner which produced the highest possible prices for these securities. A schedule of the securities so sold and the prices obtained therefor, which is a part of Ex. 120 of the record herein, is printed at p. 26 of the Appendix hereto.

The securities remaining on deposit in Wisconsin are of the highest grade and it is apparent at a glance that they may be liquidated without the slightest difficulty or expense. These securities are:

| | Par Value | Market According to Published Quotations 4-14-41 |
|---|---|---|
| City of Milwaukee— Park 5% 1949 | $ 50,000.00 | $ 62,812.50 |
| City of Milwaukee— Sewer 5% 1947 | 30,000.00 | 37,125.00 |
| City of Milwaukee— Sewer 5% 1948 | 50,000.00 | 62,562.50 |
| City of Milwaukee— Sewer 5% 1949 | 50,000.00 | 63,062.50 |
| City of Milwaukee— Sewer 5% 1950 | 25,000.00 | 32,406.25 |
| United States Treasury— 2⅞—1960-55 | 160,000.00 | 175,350.00 |
| United States Treasury— 3¼—1946-44 | 34,000.00 | 36,751.88 |
| United States Treasury— ¾ Sept. 1944 | 800,000.00 | 798,000.00 |
| | $1,199,000.00 | $1,268,070.63 |

In the face of this situation the filing of the debtor's Chapter X petition has resulted in the Wisconsin proceedings having been held in abeyance since June 6, 1941. We have heard no suggestion that some form of "slow liquidation" plan would result in more money being obtained for these securities than may be presently obtained. To delay their liquidation would only appear to evidence a willingness on the part of the proponents of the petition to speculate with the contract holders' money.

**The Iowa proceedings**

The proceedings in Iowa were likewise commenced prior to the federal proceedings, and the laws of Iowa pro-

viding for the licensing and supervision of Fidelity and the liquidation of its assets and the proceedings therein, have been described earlier in this brief (*ante*, p. 56-57). The Iowa deposit has been converted to cash.

**The proceedings in West Virginia and other states**

Neither in the record nor in the District Court's opinion is any suggestion found that the proceedings commenced in the states having deposits other than West Virginia are in any way inadequate or will not secure to the contract holders in those states an economical and speedy method for realizing on the securities deposited for their benefit. Only about one-half of the deposits in dollar amount are located in West Virginia (*ante*, p. 19). With respect to states other than West Virginia, even where the contract holders are not fully secured therein, the situation would seem to be the same as that in Wisconsin and Iowa, as discussed above.

The District Court, while apparently not questioning the adequacy of the proceedings in states other than West Virginia, set forth in its opinion certain considerations upon which it concluded that the West Virginia proceedings would not best subserve the interests of contract holders. We can add little to the discussion of this portion of the District Court's opinion by the Circuit Court of Appeals. In that part of its opinion which relates that one of the West Virginia state court receivers was connected with a law firm whose senior member had been a director of the debtor, the District Court said:

> "* * * It is not improbable that investigation into Debtor's affairs may disclose the existence of liability from some or all of the directors *to Debtor's creditors*. Is it reasonable to suppose that such liabilities, if any,

> would be diligently sought out and pursued in a proceeding with which one of Debtor's directors is so closely associated? * * *" (Emphasis supplied) (R. 198)

As pointed out by the Circuit Court of Appeals no specific facts are set out as to any liability on the part of Fidelity's former directors to its creditors, nor can we find the slightest indication of such in the record. Should such a liability be discovered at some future time, it is difficult to see how a federal trustee could enforce such a liability. We know of nothing in Chapter X which gives a trustee appointed thereunder either the right or duty to enforce claims or causes of action which creditors of the corporation may have against its directors. Section 167 (3) of Chapter X (11 U. S. C. A., sec. 567 (3)) provides that the trustee shall

> "* * * report to the judge any facts ascertained by him pertaining to fraud, misconduct, mismanagement and irregularities, and to any causes of action *available to the estate.*" (Emphasis supplied)

A trustee does not succeed to claims which might exist in favor of individuals against a debtor's directors.

> 1 Gerdes, Corporate Reorganization, para. 405;
>
> Finletter, Law of Bankruptcy Reorganization, pp. 198-199.

Assuming that a federal trustee might prosecute causes of action existing *in favor of the debtor* against individuals, no suggestion was made by the District Court that such a liability exists, nor do we know of anything in the record which would so disclose. The SEC brief stresses "the necessity for impartial investigation" to ascertain whether any such liability exists.

Fidelity has been under investigation by the SEC since prior to 1938. Counsel for the SEC participated in the entire proceedings here but no evidence was adduced and no specific facts are pointed to from which a real possibility that such liability exists could be shown. It seems inconceivable that there could be any fact relative to possible liabilities on the part of individuals to the company which has thus far escaped attention. The SEC brief refers to certain affidavits and pleadings filed by some of its counsel in the injunction suit brought against Fidelity in Detroit in 1938. The allegations of these affidavits and pleadings were expressly denied by Fidelity in its answer to the complaint and the denial was incorporated into the consent decree entered which expressly provided that it was consented to "without admitting the allegations of the complaint and denying past derelictions." See SEC report, Ex. 6, pp. 249-258. Such references made after the full and complete hearing had in this matter will hardly warrant the conclusion that the West Virginia courts and authorities will not perform their duty or that the enforcement of contract holders' rights should be further delayed and jeopardized pending a search for some solvent individual who might be liable to the company on some theory by reason of some past transaction.

It may also be pointed out that one of the West Virginia state court receivers, H. Isaiah Smith, has been placed in charge of Fidelity's affairs to act for the federal trustee, and we cannot conceive how doubts could be expressed as to the adequacy of the West Virginia proceedings in the respect just discussed under such a circumstance.

If interest on the part of state court receivers, as distinguished from the federal trustee, is to be regarded as

controlling in some measure, we believe it is proper to examine the position taken by the federal trustee in this proceeding to date. The federal trustee and its counsel took an active and, we may say leading, part in the trial of the issues presented by the controversial answers to debtor's petition. The federal trustee joins with debtor as one of the petitioners here and throughout has actively opposed at every step the position of those creditors represented in person and by state authorities who oppose the continuance of the federal proceedings. We had thought the provisions of Chapter X, particularly Section 158 thereof (11 U. S. C. A., sec. 558) relating to the disinterestedness of trustees, would necessarily preclude such participation by the trustee.

Under Section 77B it was held that a trustee appointed thereunder was not concerned with the merits of the petition or its dismissal.

> *Loomis v. Gila County*, 101 F. (2d) 827 (CCA 9th, 1939) petition for rehearing denied (with opinion) 103 F. (2d) 312; cert. den. 307 U. S. 643, 83 L. ed. 1524, 59 S. Ct. 1041.

As said in 1 Gerdes, Corporate Reorganization, para. 390:

> "In his relation with creditors and stockholders, the trustee is a fiduciary. His attitude toward all the creditors and stockholders should be the same, and no particular group should be favored over others of the same class."

The participation of the federal trustee in the trial of the issues between the debtor and the respondents here was directly challenged early and late in the hearing

(R. 300, 302, 1166, 1171). After Mr. Fleming, who as we have seen (*ante*, p. 38-40) was instrumental in filing debtor's petition and acted for it in so doing, withdrew from the trial of the issues presented by respondents' controversial answers, he was supplanted by Mr. Ray who also appeared for the debtor in the Circuit Court of Appeals and who appears here. As was pointed out to the Circuit Court of Appeals, the law firm of Mr. Ray is listed as "general counsel" for Central Trust Company, the federal trustee, although this was not known to us at the time of the hearing in the District Court. Mr. Holt, who appeared as counsel for debtor upon the application for the writ of certiorari and who now appears for it, disclosed at the bar of the Circuit Court of Appeals for the Fourth Circuit in connection with debtor's application for stay of mandate, that his law firm was also regularly employed as counsel by Central Trust Company and had in fact been consulted by it in its private interest during the course of the present proceedings in matters affecting those proceedings. We impute no motives to these counsel inconsistent with the highest standards of conduct under Chapter X or under any other standards, but we believe the circumstances indicate a position on the part of the trustee not consistent with the provisions of Section 158 of Chapter X. The independent trustee was referred to by Mr. Justice Douglas, then a member of the Securities and Exchange Commission, at the House hearings on Chapter X, as "the keystone" of the program (p. 165, Hearing before the Committee on the Judiciary, House of Representatives, 75th Congress, First Session on H. R. 6439).

Although, as we have shown, the debtor by its petition and the proof thereon wholly failed to sustain the

burden upon it to show good faith within the meaning of Section 146, the federal trustee has throughout taken upon itself that burden. And its failure of proof has been as abject as that of the debtor. To date the trustee has made only the vaguest suggestions as to how the debtor might be reorganized. It contends, however, that the proceedings should remain in federal court and urged both in the District Court and the Circuit Court of Appeals that this was desirable so that the securities could be subjected to "slow liquidation." Apparently the District Court was influenced in this direction because it said in its opinion that:

> "* * * The character of Debtor's assets is such that it would be peculiarly beneficial in its case to obtain slow and orderly liquidation, if such should be found to be the only feasible plan. The dumping upon the market of twenty million dollars worth of securities of the kind held in Debtor's portfolio would most certainly result in substantial losses, which may be avoided by slow and careful liquidation over an extended period of time. * * *" (R. 196-197)

A report filed in the District Court by the trustee on May 15, 1942, after the argument on appeal in the Circuit Court of Appeals, reveals that the trustee apparently no longer subscribes to this idea. The report is entitled "REPORT OF CENTRAL TRUST COMPANY, TRUSTEE, ON SECURITIES COMPRISING THE INVESTMENT PORTFOLIO OF FIDELITY ASSURANCE ASSOCIATION," and is printed at pp. 80 to 90 of the Appendix hereto. In this report it is said (App. 80):

> "Your Trustee further respectfully reports that all of the securities, excepting United States Treasury obligations and those rated 'A' or better, are regarded in the main by your Trustee as either falling in the so-

called 'marginal classification, or securities which cannot be regarded as satisfactory for investment of savings funds."

Each type of security is discussed and the conclusion reached that except for United States government bonds each and all of the securities comprising the state deposits should be promptly sold. In discussing state, county and municipal revenue bonds it is said (App. 82):

> "* * * The longer the delay in acting on such vulnerable securities, just to such an extent is the danger increased that satisfactory sale can be accomplished. * * *"

This is precisely in accord with the position these respondents took at the inception of the federal proceedings and with the position we take now. Nevertheless, the fact that Wisconsin had prior to the federal proceedings sold certain securities, comprising in large part municipal, railroad and industrial issues, was constantly pointed to both by the debtor and the trustee during the hearing in the District Court as having been an error and one of the chief reasons why the federal proceedings should continue. The only difference between the position which the trustee takes in its report filed May 15, 1942 and that of the respondents is that, instead of distributing the proceeds of the sales the trustee suggests that such proceeds shall be re-invested in securities of the trustee's choosing and retained by it. We can only conclude from the report that the trustee does not favor "slow and orderly liquidation" or see any purpose therein, and that it does favor speedy liquidation but *slow distribution*. The trustee apparently would do everything the states are seeking to do except to place the funds in

the hands of the contract holders who are entitled thereto. All that the trustee insists is that some plan (its nature undisclosed) shall be adopted whereby it shall have the control of the depositors' funds for an indefinite period of years. How the interests of contract holders are to be best subserved by such procedure, we cannot understand. The states emphatically disclaim any necessity for or intention of "dumping" the securities comprising the deposits on the market. See App. 26 for results of liquidation in Wisconsin.

Petitioners and the SEC suggest and have suggested an infinite number of legal questions which they conceive could arise between the state authorities and contract holders of the several states, and it is suggested that such questions should be decided in one forum.

The SEC brief advances the proposition that the state deposits may be found, after all, not to secure effectively the residents of the states for whose benefit the state deposit laws were enacted. They suggest that because of the manner in which Fidelity kept its books and because of certain provisions of the contracts, the securities which Fidelity placed on deposit with the states were impressed with a prior trust in its hands and therefore were improperly deposited with the states. Such a suggestion could hardly be heard to come from the debtor itself, whose petition is being tested in these proceedings, but in any event such speculations may be quickly disposed of. It is perhaps significant that while this question was raised frequently during the proceedings, particularly by counsel for the SEC, such counsel have consistently refused to make any positive statement as to their belief or disbelief in the theory that the state deposits were not valid as made. The District Court expressly stated that it made no determination of this point (R. 181).

The SEC brief states that when Fidelity deposited securities it made efforts to maintain segregation by series. It is then stated that "some of the state depositaries made their own selection of the securities to be deposited with them without regard to the particular fund of Fidelity to which the securities belonged." Such statements distort the record. The plain fact is, as is well known to everyone in these proceedings, that the state laws did not contemplate any segregation of securities by "funds" or "series," but merely that the securities on deposit should be of sufficient amount to secure the company's total liabilities in each particular state to the extent specified in the several laws, without regard to the fact that the company might from time to time develop and sell various "series" of contracts. And the state deposits were made on this theory during the entire life of the company. It was not until the SEC investigation in 1938 that suggestions began to be made that in some manner the securities were impressed with a trust by "funds" in the hands of the company. The great bulk of the deposits as presently constituted were made long prior to the SEC investigation. We refer to the joint statement of facts, *ante*, pp. 26 to 30, for a statement of the facts as to the various "funds" as related to the state deposits. The District Court expressly found (R. 181) that the debtor "made no attempt to proportion its deposits of securities from a particular fund to the amount of cash liabilities against that fund in the state where the securities were deposited." The Securities and Exchange Commission itself (as distinguished from its counsel) expressly found and reported to Congress that Fidelity's contracts were unsecured except for the state deposits (*ante*, pp. 28-30). And a reading of the contracts (Exs. 1-5, inclusive)

will make clear beyond all doubt that no trust was created thereby, it being expressly stated that the securities comprising the "reserves" were to be deposited "in trust as required by the laws of the State of West Virginia." The deposit law of West Virginia made provision for deposits in other states and the contracts sold in other states were, of course, subject to the provisions of the laws of such states. The trusts arose by virtue of the state laws and the deposits made thereunder and there are no other "trusts." The states, while assuming the validity of their laws, do not, as suggested by the SEC, attempt to preclude challenge thereof. The courts of Wisconsin and Iowa and of the other states are open to all who may desire on any theory to make claim against the funds on deposit there, and any questions so presented should be decided there.

The depositary states have worked in harmony during the entire course of these proceedings and should questions arise between them, we can see no reason for suggesting that they will not be determined in an expeditious and adequate manner.

It is probable that questions will arise as to who are proper claimants in any particular deposits and as to the proper measure of claims. And doubtless, there will be questions as to the relative rights of claimants in particular deposits. These are questions of state law.

*Fischer v. American United L. Ins. Co.*, 314 U. S. 549, 86 L. ed. 444, 62 S. Ct. 380 (Jan. 1942);

*American United L. Ins. Co. v. Fischer*, 130 F. (2d) 643 (CCA 8th, July 1942).

Such questions of state law involve both the rights of contract holders within the states as to the funds on deposit there and the rights of the states and their lawfully consti-

tuted administrative bodies with respect to the regulation of the debtor's business within each of the several states.

These questions are not so formidable that the state courts cannot adequately cope with them. Assuming such questions to be complex and difficult their existence would not furnish any reason for extending the scope and purpose of Chapter X. In the liquidation of any large corporation doing business in a number of states and having pledged its property in various states under various laws, it is inevitable that a number of legal questions will arise. And such questions will arise whether the liquidation be conducted in state courts or in bankruptcy proceedings in the federal courts. This situation, however, did not lead Congress to extend the scope of the reorganization statute to supplant existing procedures, whether state or federal, for liquidation, nor will the exigencies of a particular case add to the federal court's jurisdiction under Chapter X.[1]

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[1] In fact, the drafters of Chapter X considered this very question in rejecting the contention that insurance companies should be brought within the scope of the Act. A letter dated May 14, 1937 to Hon. Walter Chandler was introduced into the record of the hearing before the House Judiciary Committee, reading in part as follows:

"* * * Personally, I see no reason why insurance companies which fail should not be wound up in bankruptcy. As you know, most of these companies are operating in several States, necessitating separate receiverships or wind-ups in each State, with an enormous duplication in expenses and gross inequality of treatment between residents of various States. Sometimes, where one State happens to have a large amount of assets and another none, the policyholders are paid not on the basis of their claims prorating over the United States as a whole, but on the basis of what assets happen to be in their home State. I could give you many instances of cases where policyholders of one State are paid in full or paid a very large percentage of their claims, while at the same time policyholders of another State get little or nothing. By striking out the word 'insurance' in two places in the bill one very great abuse will be rectified."

Mr. Jacob Weinstein, one of the drafters of the bill, who appeared before the House Committee to explain its provisions, related to the Committee in reference to the letter:

"We have a letter from Mr. E. H. Elliott, an attorney of St. Louis, Mo. Mr. Elliott suggests that insurance companies be brought within the scope of corporate reorganizations. The conference has thoroughly canvassed and considered that whole subject of persons amenable to reorganization proceedings, and they have decided that in the case of insurance companies and banking corporations and the like, they be not brought within the scope of the reorganization proceedings. The cases of these companies, which are now excluded from the act—the various States have set up, first, controlling agencies in the operation of the companies; and, secondly, when companies become embarrassed, the agencies, in order to take care of them, and to liquidate them, when necessary; and it is the judgment of the conference that it would be much better to allow these companies to be liquidated or reorganized under local law, than to bring them in under the bankruptcy law. * * *"

P. 242, Hearing before Committee on the Judiciary, House of Representatives, 75th Cong., 1st Sess., on H. R. 6439.

Recent decisions of this court would indicate that were the federal proceedings to continue the District Court would be required to submit questions as to the construction of the deposit laws of the various states to the state courts of those states, where such questions had not yet been decided by the state courts.

*Thompson v. Magnolia Petroleum Co.*, 309 U. S. 478, 84 L. ed. 876, 60 S. Ct. 628 (1940);

*Railroad Commission of Texas v. Pullman Co.*, 312 U. S. 496, 85 L. ed. 971, 61 S. Ct. 643 (1941), *infra*;

*Fischer v. American United L. Ins. Co.*, 314 U. S. 549, 86 L. ed. 444, 62 S. Ct. 380 (1942).

If, in any event, the federal court would be required to refer such matters to the state courts for disposition, it seems unreasonable to suggest that a multiplicity of state court actions can be avoided by an assumption of federal jurisdiction. On the contrary, it clearly appears that such assumption of jurisdiction would result in the addition of yet another court to those which must ultimately pass upon the questions at issue. Common sense dictates that where the important questions in the case must be referred to the state courts in any event, each of those courts should be permitted to effect a complete disposition of the deposits in their respective states.

## III

## THE PUBLIC INTEREST, UNDER WELL SETTLED EQUITY PRINCIPLES APPLICABLE IN CHAPTER X PROCEEDINGS, REQUIRED DISMISSAL OF THE PETITION BY THE DISTRICT COURT

Equitable principles applicable in Chapter X proceedings required dismissal of the petition by the District Court. These principles may be considered as existing independently of the express words of Chapter X or as an aspect of the question of "good faith" within the general meaning of that term as used in Chapter X.

We advanced this contention before the Circuit Court of Appeals, and it is open here.

*Ryerson v. United States*, 312 U. S. 405, 85 L. ed. 917, 61 S. Ct. 656 (1941).

Section 77B and Chapter X were and are but an extension and codification of the rules of law and practice which had been developed in the former federal equity receivership proceedings.

Finletter, Law of Bankruptcy Reorganization (1939 ed.), pp. 1-35, particularly pp. 18-19.

This proposition is explained in the fullest of detail in *Securities and Exchange Commission v. United States R. & Imp. Co.*, 310 U. S. 434, 84 L. ed. 1293, 60 S. Ct. 1044 (1940). The question there was whether, even though it be conceded that jurisdiction to entertain the debtor's petition existed under Chapter XI of the Bankruptcy Act, the District Court should have proceeded under Chapter X on the ground that such procedure was better adapted to the circumstances of the case. It was held that even though

Chapter XI did not contain in words provisions similar to Section 146 of Chapter X, the District Court should in the exercise of sound discretion have dismissed the Chapter XI petition and remitted respondent, if it was so advised, to the initiation of a proceeding under Chapter X. During the discussion it was said:

> "A bankruptcy court is a court of equity, § 2, 11 USCA § 11, and is guided by equitable doctrines and principles except in so far as they are inconsistent with the Act. * * *" (310 U. S. 455)

We direct particular attention to the citation and discussion of the case of *Pennsylvania v. Williams*, 294 U. S. 176, 79 L. ed. 841, 55 S. Ct. 380 (1935), in the *United States R. & Imp. Co.* case. In citing that case it was said:

> "* * * A court of equity may in its discretion in the exercise of the jurisdiction committed to it grant or deny relief upon performance of a condition which will safeguard the public interest. It may in the public interest, even withhold relief altogether, and it would seem that it is bound to stay its hand in the public interest when it reasonably appears that private right will not suffer. * * *" (310 U. S. 455)

There can be no question but that the principles of *Pennsylvania v. Williams* and related cases are imported into the application of Chapter X.

In *Pennsylvania v. Williams*, 294 U. S. 176, 79 L. ed. 841, 55 S. Ct. 380 (1935), a federal District Court had appointed an equity receiver of a Pennsylvania building and loan association. Later, the appropriate authorities of Pennsylvania had intervened and moved for dismissal upon the ground that the statutes of Pennsylvania afforded a com-

plete scheme for liquidation of the association. It was held to be error for the District Court to have retained jurisdiction. It was said:

"* * * It is in the public interest that federal courts of equity should exercise their discretionary power with proper regard for the rightful independence of state governments in carrying out their domestic policy. (citing) It has long been accepted practice for the federal courts to relinquish their jurisdiction in favor of the state courts, where its exercise would involve control of or interference with the internal affairs of a domestic corporation of the state. (citing) There are stronger reasons for adopting a like practice where the exercise of jurisdiction involves an unnecessary interference by injunction with the lawful action of state officers. (citing)" (294 U. S. 185)

See also: *Gordon v. Ominsky*, 294 U. S. 186, 79 L. ed. 848, 55 S. Ct. 391 (1935);

*Penn General Casualty Co. v. Pennsylvania*, 294 U. S. 189, 79 L. ed. 850, 55 S. Ct. 386 (1935);

*Kelleam v. Maryland Casualty Co.*, 312 U. S. 377, 85 L. ed. 899, 61 S. Ct. 595 (1941);

Annotation, 96 A. L. R. 1173.

As said in *Railroad Commission of Texas v. Pullman Co.*, 312 U. S. 496, 85 L. ed. 971, 61 S. Ct. 643 (1941):

"* * * Few public interests have a higher claim upon the discretion of a federal chancellor than the avoidance of needless friction with state policies, whether the policy relates to the enforcement of the criminal law, Fenner v. Boykin, 271 U. S. 240, 70 L. ed. 927, 46 S. Ct. 492; Spielman Motor Sales Co. v. Dodge, 295 U. S. 89, 79 L. ed. 1322, 55 S. Ct. 678; or the administration of a specialized scheme for liquidating embar-

rassed business enterprises, Pennsylvania v. Williams, 294 U. S. 176, 79 L. ed. 841, 55 S. Ct. 380, 96 A. L. R. 1166; or the final authority of a state court to interpret doubtful regulatory laws of the state, Gilchrist v. Interborough Rapid Transit Co. 279 U. S. 159, 73 L. ed. 652, 49 S. Ct. 282; cf. Hawks v. Hamill, 288 U. S. 52, 61, 77 L. ed. 610, 618, 53 S. Ct. 240. These cases reflect a doctrine of abstention appropriate to our federal system whereby the federal courts, 'exercising a wise discretion,' restrain their authority because of 'scrupulous regard for the rightful independence of the state governments' and for the smooth working of the federal judiciary. See Cavanaugh v. Looney, 248 U. S. 453, 457, 63 L. ed. 354, 358, 39 S. Ct. 142; Di Giovanni v. Camden F. Ins. Asso., 296 U. S. 64, 73, 80 L. ed. 47, 53, 56 S. Ct. 1. This use of equitable powers is a contribution of the courts in furthering the harmonious relation between state and federal authority without the need of rigorous congressional restriction of those powers. * * *" (312 U. S. 500-501)

The statutes of Pennsylvania providing for the liquidation of building and loan associations are substantially identical to the statutes of Wisconsin which cover the proceedings there in this case. An even more striking application of these principles as applied to the facts of this case was made in *Brashear v. Intermountain Building & Loan Ass'n*, 109 F. (2d) 857 (CCA 9th, 1940), and in *Gallegos v. Smith*, 111 F. (2d) 805 (CCA 9th, 1940). In these latter cases the corporation, as here, had deposits in various states and the state authorities had proceeded precisely as they have done here and under statutes substantially similar.

To propose in this case that the lawful functions of the state authorities shall be suspended, the contract holders in the several states deprived of all assistance therefrom

and to relegate them to pursuance of their own remedies in a far-off federal District Court, is to flout the states and the very laws under which the contract holders assumed their relationship with the debtor, upon which they rely for the fulfillment of its obligations, and to which the debtor owed its life and business.

In their function as liquidators of insolvent financial institutions over which they have control, the Banking Commissioners of Wisconsin "are executive or administrative officers carrying out a legislative policy." *Pallange v. Liberty State Bank*, 216 Wis. 418, 421, 256 N. W. 708, 710. The states' conception of their position and duty is expressed better than we are able to do in the opinion by Mr. Justice Cardozo in *Hopkins Federal Savings and Loan Association v. Cleary*, 296 U. S. 315, 80 L. ed. 251, 56 S. Ct. 235 (1935) (cited in *Securities and Exchange Commission v. United States R. & Imp. Co.*):

> "The standing of Wisconsin to resist a trespass on its powers is confirmed if we view the subject from another angle of approach. In the creation of corporations of this quasi-public order and in keeping them thereafter within the limits of their charters, the state is parens patriae, acting in a spirit of benevolence for the welfare of its citizens. Shareholders and creditors have assumed a relation to the business in the belief that the assets will be protected by all the power of the government against use for other ends than those stated in the charter. Aside from the direct interest of the state in the preservation of agencies established for the common good, there is thus the duty of the parens patriae to keep faith with those who have put their trust in the parental power. * * *" (296 U. S. 340-341)

## CONCLUSION

It is respectfully submitted that the judgment of the Circuit Court of Appeals should be affirmed.

JOHN E. MARTIN,
*Attorney General, State of Wisconsin,*

JAMES WARD RECTOR,
*Deputy Attorney General, State of Wisconsin,*

RICKARD H. LAURITZEN,
*Assistant Attorney General, State of Wisconsin,*

*Attorneys for Respondent,*
*Banking Commission of Wisconsin.*

JOHN M. RANKIN,
*Attorney General, State of Iowa,*

FLOYD PHILBRICK,
*First Assistant Attorney General, State of Iowa,*

CARL J. STEPHENS,
BEN C. BUCKINGHAM,

*Attorneys for Respondent,*
*Charles R. Fischer, Commissioner of Insurance and Permanent Receiver for Debtor Corporation In and For the State of Iowa.*

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APPENDIX

1

# STATUTES OF WISCONSIN, INSOFAR AS PERTINENT TO THE ISSUES IN THIS CASE, TO WHICH FIDELITY ASSURANCE ASSOCIATION WAS AND IS SUBJECT

## Chapter 216

## Investment Associations

**216.01 Regulation.** No person and no copartnership, association or corporation, whether local or foreign, heretofore organized or which may hereafter be organized, doing business as a so-called investment, loan, benefit, cooperative, home, trust or guarantee company, for the licensing, control and management of which there is no law now in force in this state, and which such person, copartnership, association or corporation, shall solicit payments to be made to himself or itself either in a lump sum, or periodically, or on the instalment plan, issuing therefor so-called bonds, shares, coupons, certificates of membership or other evidences of obligation or agreement, or pretended agreement to return to the holder or owners thereof money or anything of value at some future date, shall solicit or transact any business in this state unless such person, copartnership, association or corporation, shall have first complied with all the provisions prescribed in chapter 215 of the statutes required of foreign building and loan associations authorized to do business in this state.

**216.02 Laws applicable.** All provisions of said chapter 215 with respect to the supervision, control and conditions upon which foreign building and loan associations are permitted to do business in this state are hereby made applicable to and imposed upon persons, copartnerships, associations or corporations described in the first section of this act, the same as though they were foreign building

and loan associations under said act, so far as such supervision, control and conditions can be made applicable to the particular business done by such persons, copartnerships, associations or corporations.

**216.03 Penalty.** Any person, copartnership, association or corporation who or which shall act as principal or agent in doing such business or in soliciting business for, or membership of participation in, any such copartnership, association or corporation, or solicit business for such person or persons doing business as such companies, not authorized to do business in this state, shall be deemed guilty of a misdemeanor and upon conviction thereof shall be punished by fine of not less than one hundred dollars nor more than one thousand dollars, or by imprisonment in the county jail of not less than three months, nor more than one year, or by both such fine and imprisonment.

(Secs. 216.04 to end of Chapter 216 omitted.)

## Chapter 215

## Building and Loan Associations

**215.01 Local and foreign; organization.** (1) A corporation for the purpose of raising money to be loaned among its members shall be known as a building and loan association; if organized under the laws of this state, as a local association, and if under the laws of any other state or territory, as a foreign association. The words "building and loan association" shall form part of the name of every such local association hereafter organized; and no corporation not organized under these statutes shall be entitled to use a name embodying such words, except that corporations now existing may continue their present names. The

name adopted by any association hereafter incorporated shall not be the same assumed by any other association, nor so similar as to be liable to mislead.

215.38 **Deposit.** No foreign building and loan association and no foreign association or corporation representing itself to be a building and loan association or doing business on the building-society plan, and no association or corporation organized under the laws of any other state or territory and doing business in the manner provided for mutual loan and building associations by this chapter shall issue its shares, receive moneys or transact any business in this state unless such association shall have and keep on deposit with the state treasurer, in trust for the benefit and security of all its members in this state, five hundred thousand dollars to be held in trust as aforesaid until all shares of such association held by residents of this state shall have been fully redeemed and paid off and until its contracts and obligations to persons and members residing in this state shall have been fully performed and discharged; the securities comprising such deposit shall first be approved by the banking commission under the same rules and regulations governing the approval of securities of trust company banks; and upon such deposit being made the state treasurer shall issue a certificate therefor, and thereupon the banking commission may issue its certificate of authority to said association to transact business in this state.

215.39 **Same.** The deposit to be made with the state treasurer by any foreign association may consist of bonds or treasury notes of the United States, or bonds of this state or any city, town or county of this state, having authority to issue the same. All interest which may accrue on securities held by the state treasurer may be collected, and retained by the association depositing such securities so long as such association remains solvent and performs all

contracts with its members. Any securities on deposit as provided herein, if approved by the banking commission, may from time to time be withdrawn if others of equal value and of the character named in this section are substituted therefor. If any such securities shall depreciate in value new ones must be added, so that the deposit may at all times be kept good and of the value of five hundred thousand dollars, and it shall be the duty of the banking commission to revoke the certificate of authority of any such association whenever there exists an impairment of such deposit for a period of more than thirty days after due notice to the association given by such commission.

215.395 **Increase of deposit.** Whenever the commission shall find that the liability of any foreign building and loan association or any foreign investment association on shares or contracts then outstanding or contracted for by members or persons residing in this state, exceeds ninety per cent of the amount of the deposit required by section 215.38 and section 215.39, or exceeds ninety per cent of the amount of the deposit required by such sections and by any order issued under the authority of this section, exclusive in each case, however, of any such liability under any agreement existing, created, regulated or required by the industrial commission under chapter 108 or by any other department, commission or division of a state government under any other provision of law, the commission shall issue an order to such association or corporation requiring such association or corporation to deposit within thirty days with the state treasurer, an additional amount in cash or securities of the class mentioned in section 215.39, or such other securities as the commission shall require and approve. If such order is not complied with within thirty days, the commission shall revoke the certificate of authority issued to such association or corporation.

215.41 **Conditions precedent.** Every foreign building and loan association, before commencing to do business in this state, shall:

(1) File with the banking commission a duly authenticated copy of its charter or articles of incorporation and by-laws, of its certificates of shares and of all printed matter issued by it.

(2) File with the banking commission a certificate of the state officer having charge and supervision of such associations in the state in which incorporated, certifying that such association is legally incorporated and authorized to transact business, and that similar associations incorporated under the laws of this state are permitted and licensed to transact business in such state.

(3) Pay to the banking commission one hundred dollars for filing the papers mentioned in this section. Before granting a license to any such association organized or incorporated under the laws of any other state or foreign government it shall require that every such association shall file in writing an appointment of the banking commission or its successor in office as the attorney upon whom any summons, notice or process of any court of this state may be served and stipulate that service of any such summons, notice or process upon such attorney, in any action brought upon any cause of action arising out of any business or transaction in this state, shall be accepted irrevocably as a valid service upon such association, and copies of said appointment, certified by the banking commission, shall be deemed sufficient evidence of its authority to accept service as the attorney on behalf of any such association. Each such association shall agree, in such appointment of attorney, that the license granted by the banking commission shall cease and be revoked in case such association shall remove or make application to remove into any court of the United States any action or proceeding commenced

in any court of this state upon a claim or cause of action arising out of any business or transaction done in this state, and it shall be the imperative duty of the banking commission to revoke any and every authority, license or certificate granted to any such association violating the provisions of this section, and no such association shall have its license or certificate of authority renewed for three years after such revocation, and shall agree that in the event of revocation of license such appointment of the banking commission shall continue for the purpose of serving process for beginning actions upon any certificate of stock or liability incurred or contracted in this state while it transacted business therein, so long as any liability shall exist. When legal process against any such association is served upon the banking commission, it shall immediately notify the association of such service by letter and inclose a copy of the process served on it to said association or to any person designated by the officers thereof in writing. The plaintiff, for each process so served, shall pay to the banking commission, or, at the time of such service, a fee of two dollars, which shall be recovered by the plaintiff as a part of the taxable costs if it prevail in the suit. The banking commission shall keep a record of all process served on it, which record shall show the day and hour when such service was so made, and all the fees received by it on account of the service of such process shall be paid into the state treasury.

**215.45 Agents; fee.** No person shall act as the agent or representative of any foreign building and loan association until after he shall, at the request of such association, have procured from the banking commission a license reciting the fact that such association is authorized and licensed to transact business in this state and has complied with all lawful requirements. The fee for such license shall be twenty-five dollars, and the license shall continue in

force, unless sooner revoked by the commission, during and until the close of the fiscal year of the association.

**215.46 . Withdrawing securities.** Any foreign building and loan association, having made the deposit of securities required by this chapter, and desiring to withdraw the same or any of them without depositing securities of like character and amount, or desiring to discontinue its business or withdraw from the state, may do so by complying with the following provisions: File with the banking commission a statement reciting the reasons for desiring to withdraw such securities and the amount to be withdrawn; and the commission shall thereupon examine such association and determine the amount of its liabilities on account of all agreements or contracts outstanding with residents of this state, and if convinced that the interests of such residents will not be injured or jeopardized by such withdrawal shall cause to be published in three newspapers in this state for three weeks, at the expense of the association, notice of such request for the withdrawal of such securities, and if no written objection is filed by any resident of this state holding any share, certificate, bond or other evidence of indebtedness of or against such association within one week after the last date of the publication of such request the banking commission shall issue a certificate certifying to the state treasurer the amount of liabilities, if any, existing in this state and the amount of securities such association shall be permitted to withdraw, and upon filing a receipt for such amount the association shall be permitted to withdraw the same; provided, that there shall remain at all times a sufficient deposit to protect residents of this state holding shares, certificates, bonds or other evidences of indebtedness of or against such association and that such deposit shall decrease only as the liabilities of such association decrease on account of such residents.

**215.33 Possession by banking commission.** (1) CONDITIONS FOR TAKING POSSESSION. The banking commission may forthwith take possession and control of the business and property of any association to which this chapter is applicable whenever it shall find that such association:

(a) Is conducting its business contrary to law, or,

(b) Has violated its charter, or any law, or

(c) Is conducting its business in an unauthorized or unsafe manner, or

(d) Is in an unsound or unsafe condition to transact its business, or

(e) Has an impairment of its capital, or

(f) Cannot with safety and expediency continue business, or

(g) Has suspended payment of its obligations, or

(h) Has neglected or refused to comply with the terms of a duly issued order of the commission, or

(i) Has refused to submit its books, papers, records, or affairs for inspection to any examiner, or

(j) Has refused to be examined upon oath regarding its affairs.

(2) PROCEDURE ON TAKING POSSESSION. Upon taking possession of the business and property of any such association the banking commission shall forthwith:

(a) Serve a notice in writing upon the president and secretary of said association, setting forth therein that it has taken possession and control of the business and property of said association. Said notice shall be executed in duplicate, and immediately after the same has been served, one of the said notices shall be filed with the clerk of the circuit court of the county where said association is located, together with proof of service.

(b) Give notice to all individuals, partnerships, corporations and associations known to the banking commis-

sion to be holding or in possession of any assets of such association.

(c) The banking commission may appoint one or more special deputy commissioners as agent or agents to assist in the duty of liquidation and distribution of the assets of one or more building and loan associations of whose business and property the banking commission shall have taken possession pursuant to the provisions of this chapter. A certificate of such appointment shall be filed in the office of the banking commission and a certified copy in the office of the clerk of the circuit court for the county in which such building and loan association is located. The banking commission may employ such counsel and procure such expert assistance and advice as may be necessary in the liquidation and distribution of the assets of such building and loan associations, and may retain such of the officers or employes of such building and loan associations as they may deem necessary. The special deputy commissioner and assistants shall furnish such security for the faithful discharge of their duties as the banking commission deems proper. Such special deputy commissioner may execute, acknowledge and deliver any and all deeds, assignments, releases or other instruments necessary and proper to effect any sale and transfer or incumberance of real estate or personal property and may borrow money for use in the liquidation after the same has been approved by the banking commission, and an order obtained from the circuit court of the county in which said association is located, as hereinafter provided.

(d) Upon taking possession of the property and business of such building and loan association, the special deputy commissioner of banking is authorized to collect all moneys due to such building and loan association, and do such other acts as are necessary to conserve its assets and business, and shall proceed to liquidate the affairs thereof

as hereinafter provided. He shall collect all debts due and claims belonging to it, and upon a petition approved by the banking commission and upon order of the circuit court of the county in which such association is located, may sell or compound all bad or doubtful debts, or do any act or execute any other necessary instruments and upon like petition and order may sell all the real and personal property of such building and loan association on such terms as the court shall approve. Such special deputy commissioner may, if necessary, enforce individual liability of the stockholders to pay the debts of such corporation.

(e) The banking commission may, in the event of its taking possession of any building and loan association, the shares or share accounts of which are to any extent insured by the federal savings and loan insurance corporation, tender to said corporation the appointment as statutory liquidator of such association. If it does not make such tender it shall tender to said federal savings and loan insurance corporation the appointment as statutory coliquidator of such association to act jointly with the banking commission, but such coliquidatorship shall not extend over a period of more than one year from the date of such tender, at the expiration of which time the banking commission shall become the sole liquidator except as herein otherwise provided. The commission shall tender to said corporation the appointment as sole statutory liquidator of such association whenever said corporation shall have become subrogated to the rights of at least 90 per cent of the outstanding liability of such association on shares and share accounts; and if in addition said corporation shall have deposited with the clerk of the circuit court for the county in which such association is located shares or share accounts in a local insured association not in default at least equal in amount to the shares and share accounts as to which the corporation has not become subrogated, or if the corporation shall become

subrogated as to all the shares and share accounts in such association, it may then exercise all the powers and privileges herein conferred upon it without court order or approval. It shall be the duty of such clerk to accept such deposit for the benefit of the persons entitled to such shares or share accounts.

(f) If said corporation accepts such appointment as sole liquidator it shall have and possess all the powers and privileges given by the laws of this state to the banking commission as statutory liquidator of a possessed building and loan association, as provided in section 215.33 or otherwise, including section 215.116 and be subject to all the duties of the banking commission as such statutory sole liquidator, except in so far as such powers, privileges or duties are in conflict with the provision of any applicable federal laws, and except as herein otherwise provided, unless and until such association shall resume business, pursuant to subsection (11) or subsection (12) of section 215.33. If said corporation accepts such appointment as coliquidator it shall have and possess such powers and privileges equally and jointly with the banking commission and shall be subject to such duties equally and jointly with said commission.

(g) In the event said federal savings and loan insurance corporation shall accept the appointment as such coliquidator or liquidator, it shall file such acceptance with the banking commission and the clerk of the circuit court of the county in which the association is located and it is authorized and empowered to be and act, without bond, as such coliquidator or liquidator. Upon the filing by said federal savings and loan insurance corporation of its acceptance of the appointment as such sole liquidator, the possession of and title to all the assets, business and property of such association of every kind and nature shall pass to and vest in said corporation without the execution of any instru-

ments of conveyance, assignments, transfer or indorsement. Upon the filing by said corporation of its acceptance of the appointment as coliquidator such possession and title shall pass to and be vested in the banking commission and said corporation jointly. In the event said corporation shall not qualify as sole liquidator at or before the time herein provided for the expiration of such coliquidatorship, said corporation shall be wholly divested of and from such joint title and possession and the sole title and possession shall thereupon vest immediately in the banking commission. The vesting of title and the possession of the property and assets of such association, as provided by subsection (8) of section 215.33, shall not render such property or assets subject to any claims or demands against the federal savings and loan insurance corporation, except such as may be incurred by such corporation with respect to such association and its property or assets. Whether or not it shall serve as aforesaid, the federal savings and loan insurance corporation may make loans on the security of or may purchase, with the approval of the court, except as herein otherwise provided, at public or private sale, all or any part of the assets of any association, the shares, share accounts or accounts of which are to any extent insured by it, but in the event of such sale and purchase, said corporation shall bid for and pay a fair and reasonable price.

(h) Whether or not said federal savings and loan insurance corporation shall serve as liquidator of any such association, whenever it shall pay or make available for payment the shares, share accounts or accounts of any such association in liquidation which are insured by it, it shall be subrogated upon the surrender and transfer to it of any such shares, share accounts or accounts, with respect to such shares, share accounts or accounts, but such surrender and transfer shall not affect any right which the transferor may have in any portion of such shares, share accounts or

accounts which are not paid or made available for payment, or any right to participate in the distribution of the net proceeds remaining from the disposition of the assets of such association; provided, that the rights of the investors and creditors of such association shall be determined in accordance with the applicable provisions of the laws of this state.

(3) NOTICE, ALLOWANCE AND PAYMENT OF CLAIMS. The special deputy commissioner of banking shall cause notice to be given by advertisement in such newspapers as he may direct, weekly, for 3 consecutive weeks, calling on all persons who may have claims against such building and loan association, to present the same to the special deputy commissioner of banking, and make legal proof thereof at a place and within a time, not earlier than the last day of publication, to be therein specified. He shall mail a similar notice to all persons at their last known address, whose names appear as creditors upon the books of the building and loan association. Proof of service of such notice shall be filed with the clerk of said court. The special deputy commissioner may reject any claim. Any party interested may also file written objections to any claim with the special deputy commissioner of banking and after notice by registered mail of such rejection, said claimant shall be barred unless he commences an action thereon within 3 months. Claims presented after the expiration of the time fixed in the notice to creditors shall be entitled to share in the distribution only to the extent of the assets then in the hands of the special deputy commissioner of banking equitably applicable thereto.

(4) INVENTORY OF ASSETS AND STATEMENT OF LIABILITIES. Upon taking possession of the property and assets of such building and loan association, the special deputy commissioner of banking shall make an inventory of the assets of such building and loan association, in duplicate, one to be

filed in the office of the banking commission, and one in the office of the clerk of circuit court for the county in which such building and loan association is located. Upon the expiration of the time fixed for the presentation of claims, the special deputy commissioner of banking shall make in duplicate a full and complete list of the claims presented, including and specifying such claims as have been rejected by him, one to be filed in the office of the banking commission, and one in the office of the clerk of circuit court for the county in which such building and loan association is located. Such inventory and list of claims shall be open at all reasonable times to inspection.

(5) ADJUSTMENT OF LOANS AND WITHDRAWAL VALUE OF SHARES. The value of shares pledged upon a loan to such association shall be applied and credited to such loan and the borrower shall be liable only for the balance. The rate of interest charged upon such balance shall be the legal rate. The value shall be determined in such manner as the banking commission prescribes, and shall be made pursuant to subsections (1) and (3) of section 215.332, or in such other manner as the banking commission may prescribe. Upon the approval of such value by the banking commission and the circuit court of the county in which such building and loan association is located, the book value of each member shall be reduced proportionately. At least 5 days' written notice of such determination of value shall be given to all shareholders of the time and place such value shall be submitted to the circuit court for approval. Should any stockholder or creditor of such association feel aggrieved by any such determination of value, he may at any time within 15 days after the mailing of a notice by the banking commission, addressed to the last known address of such party, giving notice of such determination and value of such shares, appeal to the supreme court. After the creditors of such association shall have been paid, the associa-

tion, and the members thereof, may avail themselves of the provisions of section 215.116.

(6) COMPENSATION AND EXPENSES IN CONNECTION WITH LIQUIDATION. The compensation of the special deputy commissioners, counsel and other employes and assistants, and all expenses of supervision and liquidation shall be fixed by the banking commission, subject to the approval of the circuit court for the county in which such building and loan association is located, and shall upon the certificate of the banking commission be paid out of the funds of such building and loan association. Expenses of supervision and liquidation shall include the cost of the service rendered by the building and loan division of the banking department to the building and loan association being liquidated and shall be determined from time to time by the banking commission and shall be paid to the banking department from the assets of the building and loan association as other expenses of liquidation are paid. The moneys collected by the special deputy commissioner of banking shall be from time to time deposited in one or more state banks, and, in case of the suspension or insolvency of the depository, such deposits shall be preferred before all other deposits.

(7) DIVIDENDS. At any time after the expiration of the date fixed for the presentation of claims, the special deputy commissioner of banking in charge of the liquidation of such building and loan association may, upon a petition approved by the banking commission and an order of the circuit court of the county in which such building and loan association is located, out of the funds remaining, after the payment of expenses and debts, declare one or more dividends, and may declare a final dividend, such dividend to be paid to such persons, and in such amounts as may be directed by the circuit court.

(8) TITLE PASSES TO BANKING COMMISSION. Immediately upon filing the notice as provided for in subsection (2)

of section 215.33, the possession of all assets and property of such building and loan association of every kind and nature, wheresoever situated, shall be deemed to be transferred from such association to, and assumed by the banking commission; and filing of the notice mentioned herein, shall of itself, and without the execution or delivery of any instruments of conveyance, assignment, transfer or indorsement, vest the title to all such assets and property in the banking commission. Such filing shall also operate as a bar to any attachment, garnishment, execution or other legal proceedings against such building and loan association, or its assets and property, or its liabilities.

(9) EFFECT OF POSSESSION. No building and loan association shall have a lien, or charge for any payment, advance or clearance made, or liability thereafter incurred, against any of the assets of the building and loan association of whose property and business the banking commission shall have taken possession.

(10) APPEAL. Whenever any such building and loan association whose property and business the banking commission has taken possession of, as aforesaid, deems itself aggrieved thereby, it may, at any time within ten days after such taking, apply to the circuit court of Dane county to enjoin further proceedings; and said court after citing the banking commission to show cause why further proceedings should not be enjoined and hearing all allegations and proofs of the parties and determining the facts, may, upon the merits dismiss such application or enjoin the banking commission from further proceedings, and direct it to surrender such business and property to such building and loan association.

(11) REINSTATEMENT. Whenever the banking commission shall have taken over the possession and control of the business and property of any building and loan association, the same may resume business when and if:

(a) The owners of at least two-thirds of such association's dollar value of outstanding shares, execute a petition to such effect, the form of which shall be prescribed by the banking commission, and

(b) There is submitted to the banking commission by such shareholders or a committee duly selected by them, a plan for the reorganization and reinstatement of such association, and

(c) The banking commission recommends that control of the business and property of such association be returned to the shareholders, and

(d) The court in which such liquidation is pending, upon application of the banking commission, makes an order approving the banking commission recommendations, which order shall contain a finding that such association will be in a safe and sound condition when control is resumed by the shareholders.

(12) REINSTATEMENT UPON RESTRICTED BASIS. Such building and loan association may also resume business upon a restricted basis, and upon such limitations and conditions as may be prescribed by the banking commission when approved by the circuit court in and for the county in which such building and loan association is located, upon application of the banking commission. Such restrictions and conditions may include, among others, a prohibition against the selling of new shares, reasonable restrictions upon withdrawals and the payment of other liabilities. Such association shall thereupon be relieved from the control and supervision of the banking commission as provided in this section, but nothing herein shall, in any manner, prohibit the banking commission from again proceeding against such association as provided herein.

(13) LIQUIDATING DIVIDENDS AND UNCLAIMED FUNDS. (a) Unclaimed liquidating dividends and unclaimed funds remaining unpaid in the hands of the special deputy com-

missioner of banking for six months after the order for final distribution shall be by him deposited in one or more state banks, to the credit of the banking commission in its name, in trust for the several shareholders and creditors. The banking commission shall include in its annual report to the governor the names of building and loan associations so taken possession of and liquidated, and the sums of unclaimed and unpaid liquidating dividends and unclaimed funds with respect to each of them respectively, including a statement of interest earned upon such funds.

(b) The banking commission may pay over the moneys so held by it to the persons respectively entitled thereto, upon being furnished satisfactory evidence of their right to the same. In case of doubt or conflicting claims, it may require an order of the circuit court authorizing and directing the payment thereof. It may apply the interest earned by the moneys so held by it towards defraying the expenses in the payment and distribution of such unclaimed liquidating dividends and funds to the stockholders and creditors entitled to receive the same.

(Other portions of Chapter 215 omitted as not pertinent.)

## Chapter 189

## Securities Law

**189.12 Limitation of sales.** No person shall sell or offer for sale in this state any security unless registered under section 189.13; • • •

**189.13 Registration of securities.** (1) Securities shall be registered under this chapter upon application and in the manner provided in this section.

(2) The application for registration shall be signed by the issuer or a licensed dealer, shall be verified and shall be filed with the department. It shall contain such information and representations as the department may require as necessary or appropriate in the public interest or for the protection of investors.

(3) The department shall examine such application and the other papers and documents filed therewith, and may make or have made a detailed inspection, appraisal, audit, or other investigation of the property and affairs of the issuer. The department, upon payment of the expense reasonably attributable to its investigation, shall by order register the securities covered by such application if the following shall be made to appear to the department:

(a) The proposed plan of business of the issuer is not unlawful, dishonest, fraudulent, or otherwise contrary to public policy.

(b) The plan of financing is not or does not tend to be unfair, inequitable or fraudulent, or against public interest or the interest of investors.

(c) The articles of incorporation or association, declaration of trust, charter, constitution, by-laws, lease, contract, or any instrument or indenture under which the securities are issued is not contrary to law or unfair, inequitable, or fraudulent.

(d) The class of securities for which registration is sought bears a reasonable proportion to other classes of securities and to the fair value of the property and business, due consideration being given to the nature of the business, its earnings, its credit and propects, the possibility that the fair value of the property and business may change from time to time, the effect which the issue of such securities may have on the management and operation of the business by reason of the relative amount of finan-

cial interest which the various classes of security holders will have in the business, and to other relevant matters.

(e) The commissions, fees and expenses to be incurred in connection with such issue or the sale thereof or the gross or net profit of any party or parties in connection therewith, is not unreasonable.

(f) The advertising matter to be used in the sale of the securities is not false, unfair, inequitable, fraudulent or misleading and gives fair and reasonably adequate information with reference to the securities and the issuer.

(g) It does not appear that any relationship exists between the issuer and the trustee in any instrument under which the securities have been or are to be issued, by virtue of which the interests of the trustee might be in conflict with the interests of purchasers.

(h) The methods to be used in the sale of the securities are not such as to be misleading, unfair, inequitable or fraudulent as to the purchasers, or against public interest or the interest of investors. Unless the foregoing shall be made to appear to the department, the department shall issue its findings and order denying registration.

(Other portions of Chapter 189 omitted as not pertinent.)

## NOTICE OF TAKING CONTROL OF WISCONSIN BUSINESS AND PROPERTY OF FIDELITY ASSURANCE ASSOCIATION

**(From Ex. 120)**

(Caption Omitted)

To: Fidelity Assurance Association
Wheeling, West Virginia

F. S. Risley, President
Fidelity Assurance Association
Wheeling, West Virginia

Frank J. McNulty, Vice President and Secretary
Fidelity Assurance Association
Wheeling, West Virginia

H. Isaiah Smith
Ross B. Thomas
Receivers of Fidelity Assurance Association
Charleston, West Virginia

PLEASE TAKE NOTICE:

That the Banking Commission of Wisconsin, acting pursuant to the provisions of Chapter 216 and Chapter 215, Wisconsin Statutes, particularly section 215.33 thereof, and pursuant to the order of the Circuit Court for Dane County made and entered on April 14, 1941, has taken possession and control of all of the business and property located in the State of Wisconsin of Fidelity Assurance Association.

This notice, executed this 26th day of April, 1941.

BANKING COMMISSION OF WISCONSIN

By Frank H. Bixby /s/
Frank H. Bixby
Commissioner of Banking

(SEAL)

## ORDER OF CIRCUIT COURT FOR DANE COUNTY, WISCONSIN, APRIL 14, 1941

**(From Ex. 120)**

(Caption Omitted)

On reading and filing the petition of the Banking Commission of Wisconsin dated April 14, 1941, and said Commission appearing by Frank H. Bixby, Commissioner of Banking; John E. Martin, Attorney General; and Rickard H. Lauritzen, Assistant Attorney General; and said Fidelity Assurance Association appearing by its attorneys Rieser and Mathys by R. M. Rieser, and the Court being advised as to the nature and purpose of the petition, and being satisfied that the petition sets forth facts sufficient to support an order to be entered herein, and that facts exist establishing the jurisdiction of the Court and that it is necessary and desirable that an order be promptly entered herein;

NOW, THEREFORE, IT IS ORDERED:

1. That possession and control of all of the property, business and assets of Fidelity Assurance Association, a corporation organized and existing under the laws of the State of West Virginia, located in the State of Wisconsin of whatever nature and wherever located in the State of Wisconsin be and the same hereby is vested in the Banking Commission of Wisconsin; and said Commission is hereby ordered to forthwith take possession of and hold said property, said property to be administered by the Banking Commission of Wisconsin under the supervision and con-

trol of the Circuit Court for Dane County, Wisconsin, for the benefit and security of contract, bond or certificate holders, residents of this State, and other creditors of said Association located in Wisconsin.

2. That title to the securities heretofore deposited by said Fidelity Assurance Association with the State Treasurer of Wisconsin as set forth in said petition, being securities having a market value as of February 28, 1941, as set forth in said petition, of $2,606,883.16, and interest coupons appertaining thereto in the amount of $28,394.53, likewise on deposit with the State Treasurer of Wisconsin, in trust for the benefit and security of Wisconsin contract, bond or certificate holders and creditors, be likewise vested in the Banking Commission of Wisconsin, custody and possession of such deposited assets, however, to remain in the State Treasurer of Wisconsin pending the further order of the Court.

3. That the prosecution or the taking of any proceedings in and relative to the suit entitled "H. L. Currie vs. Fidelity Assurance Association" now pending in the Circuit Court for La Crosse County, Wisconsin, and the taking of any proceedings relative to any other suits which may have been commenced against said Association in the Courts of Wisconsin, and the commencement and prosecution of any and all actions against said Association in the Courts of the State of Wisconsin, is hereby enjoined.

4. That the expenses of the Banking Commission of Wisconsin in administering the business and assets of said Association located in Wisconsin be paid out of the assets of said Association located in the State of Wisconsin.

5. That the Banking Commission of Wisconsin be and the same hereby is authorized and empowered to forthwith ascertain the names and identity of all contract, bond or certificate holders and creditors of said Association located in Wisconsin, the nature of the contracts, bonds or certificates and claims held by each of such Wisconsin bond, contract or certificate holders and creditors and the respective amounts of such contracts, bonds or certificates and claims.

6. That the Banking Commission of Wisconsin be and the same is hereby empowered to seek from time to time the further advice of the Court and further orders relative to the administration of the assets of said Association.

7. That a copy of this order be forthwith served upon the said Fidelity Assurance Association, upon the State Treasurer of Wisconsin, upon the plaintiff's attorney in the aforementioned suit, entitled "H. L. Currie vs. Fidelity Assurance Association," now pending in the Circuit Court for La Crosse County, Wisconsin, upon any and all banks, depositaries or other persons, firms or corporations which the said Banking Commission of Wisconsin may find to have in possession any assets of said Association, and upon any and all persons whom said Banking Commission of Wisconsin may find to have commenced or to be about to commence any suit of any kind or nature against said Fidelity Assurance Association in the Courts of the State of Wisconsin.

8. Whenever a certified copy of this order shall be presented by the Banking Commission to any bank or

other depositary or debtor of said Association in the State of Wisconsin it shall constitute full authority for the payment or surrender to the Commission of any funds, property or assets of said Association demanded by said Commission.

9. It is further ordered that delivery of a copy of this order either before or after the commencement of any suit or other action herein enjoined shall constitute due notice to such person of the injunctions, prohibitions, restraints and orders herein contained and hereby ordered, as well as of all other terms and provisions hereof affecting any such person, and shall thereafter be binding upon such person, his agents, attorneys and representatives.

Dated April 14, 1941.

AUGUST C. HOPPMANN
Circuit Judge

SCHEDULE OF FIDELITY ASSURANCE ASSOCIATION BONDS SOLD BY BANKING COMMISSION OF WISCONSIN MAY 27, 1941 (From Ex. 120)

| Issue | Rate | Maturity | Par | Price | SOLD FOR Principal Amount | Accrued Interest | Total Proceeds |
|---|---|---|---|---|---|---|---|
| *Harriman—Ripley Company* | | | | | | | |
| Remington-Rand, Inc.—20 Year Debenture (WW) | 4¼% | 3/1/56 | $ 75,000.00 | 104-1/4 | $ 78,187.50 | $ 770.31 | $ 78,957.81 |
| Champion Paper & Fibre Co. S. F. Deb. (9/1/35) | 4¾ | 9/1/50 | 11,000.00 | 106 | 11,660.00 | 126.27 | 11,786.27 |
| Reading Company—General & Refunding B | 4½ | 1/1/97 | 25,000.00 | 82 | 20,500.00 | 459.38 | 20,959.38 |
| City of Ashland—Waterworks (12/1/35) | 4 | 12/1/51 | 19,000.00 | 115.0498 | | 373.67 | |
| City of Ashland—Waterworks (12/1/35) | 4 | 12/1/52 | 20,000.00 | 115.8567 | 74,475.24 | 393.33 | 75,733.91 |
| City of Ashland—Waterworks (12/1/35) | 4 | 12/1/54 | 22,000.00 | 117.7559 | | 432.67 | |
| City of Ashland—Waterworks (12/1/35) | 4 | 12/1/56 | 3,000.00 | 117.9379 | | 59.00 | |
| U. S. Treasury Bonds | 2¾ | 6/15/63-58 | 25,000.00 | 110-6/32 | 27,546.88 | 311.28 | 27,858.16 |
| U. S. Treasury Bonds | 2¾ | 12/15/65-60 | 150,000.00 | 110-19/32 | 165,890.63 | 1,867.71 | 167,758.34 |
| U. S. Treasury Bonds | 2¾ | 9/15/59-56 | 150,000.00 | 109-26/32 | 164,718.75 | 836.46 | 165,555.21 |
| U. S. Treasury Notes | ¾ | 9/15/44 | 617,000.00 | 100-7/32 | 618,349.69 | 930.53 | 619,280.22 |
| TOTAL | | | $1,117,000.00 | | $1,161,328.69 | $6,560.61 | $1,167,889.30 |
| *First Boston Corporation* | | | | | | | |
| Ohio Edison Company—1st Mtge.—Series 1935 | 4 % | 11/1/65 | $ 25,000.00 | 107-7/16 | $ 26,859.38 | $ 75.00 | $ 26,934.38 |
| U. S. Treasury Bond | 3 | 9/15/55-51 | 1,000.00 | 112 | 1,120.00 | 6.08 | 1,126.08 |
| TOTAL | | | $ 26,000.00 | | $ 27,979.38 | $ 81.08 | $ 28,060.46 |
| *Smith Barney & Company* | | | | | | | |
| Wilson & Co.—Conv. Deb. | 3¾% | 4/1/47 | $ 50,000.00 | 103-3/8 | $ 51,687.50 | $ 296.88 | $ 51,984.38 |
| *Holley-Dayton & Gernon* | | | | | | | |
| City of Kenosha—Street Widening (2/1/31) | 4½% | 2/1/45 | $ 10,000.00 | 111.63 | $ 11,163.65 | $ 146.25 | $ 11,309.90 |
| GRAND TOTAL | | | $1,203,000.00 | | $1,252,159.22 | $7,084.82 | $1,259,244.04 |

## AFFIDAVIT OF HOWARD L. SMITH, SPECIAL DEPUTY COMMISSIONER OF BANKING

**(Exhibit 114)**

(Caption Omitted)

Howard L. Smith being first duly sworn on oath deposes and says:

1. That he is an adult resident of the City of Madison, Dane County, Wisconsin, and is by profession a Certified Public Accountant, and that on the 25th day of April, 1941, he was duly appointed by the Banking Commission of Wisconsin, Special Deputy Commissioner of Banking to assist in the liquidation of the Wisconsin assets of the Fidelity Assurance Association, and that this appointment was confirmed by the Circuit Court for Dane County having jurisdiction of said proceedings.

2. That as such Special Deputy Commissioner of Banking, he has been since April 25th, 1941, in charge of the liquidation of the Wisconsin assets of Fidelity Assurance Association and has official custody and supervision over all of the records and files of said liquidation and has charge of all matters pertaining thereto.

3. That he prepared claim forms for the filing of claims of Wisconsin contract holders of Fidelity Assurance Association, and that he is familiar with the claims filed by said contract holders and with all of the correspondence had with such contract holders relating thereto.

4. That on said claim forms there was provided a space for "comments" to be made by said contract holders if they so desired, and that upon said claim forms which had been

filed in the approximate number of fifty-four hundred, many of said contract holders have voluntarily expressed their sentiments relative to possible reorganization of Fidelity Assurance Association and that of such contract holders so expressing themselves, a total of one hundred thirty-four have indicated clearly that they are in no way interested in a possible reorganization of Fidelity Assurance Association and are desirous of having paid to them the present value of their contracts.

5. That a number of said contract holders in the space provided for said "comments" have indicated that they purchased said contracts upon the express representations made by the salesman of Fidelity Assurance Association that the liability of the Association to them upon such contracts was fully protected by a deposit made with the State Treasurer of Wisconsin by said Association. A total of seventy-four of such contract holders have voluntarily expressed themselves in this manner.

6. That although in published notices given by the Banking Commission of Wisconsin it was indicated that a reorganization of said company might at some future time be effected, the overwhelming majority of those expressing themselves in this regard in the space provided for "comments" on the claim forms filed by them have as above stated, indicated that they desire to have the present value of their contracts paid to them.

7. That a number of Wisconsin contract holders have corresponded by letter with the Banking Commission of Wisconsin and have expressed themselves with respect to possible reorganization and also as to the representations upon which they purchased such contracts. In sixty-two letters containing expressions in this regard, contract hold-

ers have clearly indicated that they do not favor a reorganization of the company and desire to have paid to them the present value of their contracts, and in twenty-six of said letters which contained expressions in this regard, the contract holders stated that they had been assured by representatives of Fidelity Assurance Association that the liability of the company to them was fully protected by a deposit made with the State Treasurer of Wisconsin.

8. That of all the written communications received by way of "comments" attached to claim forms or by letters from contract holders aggregating over forty-three hundred in all, only eleven contract holders expressed themselves as in any way in favor of a possible reorganization of Fidelity Assurance Association, copies of these eleven communications being attached hereto and made a part hereof.

9. That affiant as such Special Deputy Commissioner of Banking has talked personally with a large number of contract holders aggregating to the best of his knowledge and belief between two and three hundred in number and that practically all of said contract holders expressed themselves as not being interested in possible reorganization plans affecting Fidelity Assurance Association and they desired to have the present value of their contracts paid to them by the Banking Commission of Wisconsin and that a great number of them further indicated that they had purchased their contracts on the express representation that the liability of the company to them was fully protected by a deposit made with the State Treasurer of Wisconsin by the company and that they were of the firm belief that the amount of this liability should not be reduced and that it should be paid to them.

10. That from his knowledge of the affairs of Fidelity Assurance Association in Wisconsin as such Special Deputy

Commissioner of Banking, affiant is firmly convinced that few, if any, Wisconsin contract holders would consent to a plan of reorganization which would involve a reduction in the present value of their contracts. That from his knowledge of said affairs, affiant is further convinced that said Wisconsin contract holders having purchased their contracts on the express representation that in the event of a default they would be protected by the Wisconsin deposits have become greatly aroused and incensed by reason of the fact that Fidelity Assurance Association has sought to prevent the prompt payment of their claims out of the Wisconsin deposits and have sought to have said deposits removed from the State of Wisconsin and subjected to the jurisdiction of a Federal Court in the Southern District of West Virginia. That by reason of the present attitude of Wisconsin contract holders affiant is of the belief that it would be extremely difficult, if not impossible, to secure the consent of any appreciable number of said contract holders to any proposed plan of reorganization involving any modification either of the present value or the matured value of their contracts.

Dated at Madison, Wisconsin, this 10th day of September, 1941.

Howard L. Smith
Special Deputy Commissioner
Banking Commission of Wisconsin

Subscribed and sworn to before me this
11th day of September, 1941.

Lucille Mueller
Notary Public, Dane County, Wisconsin
My Commission Expires: July 2, 1944

## COMMENTS MADE TO BANKING COMMISSION OF WISCONSIN BY WISCONSIN CONTRACT HOLDERS IN CONNECTION WITH CLAIMS FILED, REFERRED TO IN PARAGRAPH 8 OF FOREGOING AFFIDAVIT AND ATTACHED THERETO

(Claim Forms to which Comments attached Omitted)

"Should you have any reorganization plan we would consider that rather than accept a cash settlement."—Obert Johnson, Osseo, Wis. (Claim No. 2253)

"As a matter of fact I am not anxious to cash in these contracts if the banking commission in West Virginia gets the company on its feet again. I received a letter in May from the commission asking if they should draw on my account as the Fidelity company had been doing and I gave them permission to do so. This money of course is in a separate fund but I presume the insurance these contracts represent is still in force. * * * The thought has just occurred to me that we in this state should at least receive the amount of money we actually paid in; instead of the cash surrender value as I have figured it; inasmuch as the banking department had at least 100% coverage on the money we sent out east."—W. B. Southard (Claim No. 2550)

"If Company is Reorganized intehd to leave amount in for ten years if possible and collect full amount at that time."—Ernest N. Peterson, Wausau, Wis. (Claim No. 1508)

"Don't intend to cash contract, as surrender value so small (for only a year). Hope this amount could be used for Insurance policy after firm is reorganized or leave amount in for 10 yrs. (14 months paid in $105.00)"—Hilda Zeier Peterson, Wausau, Wis. (Claim No. 1510)

"I have paid in $15.00 per mo. for eleven months—the cash surrender value is much less I know—I took a loss of $200.00 on a cash surrender of another contract—I think I

should have the $165 in this case. P.S. A reliable insurance policy (*reliable* company) will be acceptable—but not a loss of money paid in."—Frances K. Tipple, Taycheedah, Wis. (Claim No. 2245)

"If the Fidelity Association should prove solvent and reorganize then, I would want to resume my contract and not have to suffer the loss that this surrender makes. Will the warrant be honored under these circumstances? Before cashing takes place will a report be made to us on the status of Fidelity at the time? I do not want to take the cash surrender value if I can avoid that loss."—Ralph A. Borah. (Claim No. 2364)

"If a reorganization of the company is effected I would like to be notified of the details before final settlement of the cash surrender value is made."—Richard J. Feil, Madison, Wis. (Claim No. 2371)

"I don't know just what the cash surrender value of this contract would be but as of April 10 I have paid in 5 years and 2 months of $930 which does not take into account any interest they may have credited me with. If I understand their cash commuted value schedule this contract would rate the 6th coupon or $749 plus 2 extra months, which being 1/6 of the year would amount to $31. On these two contracts therefor I will be forced to take a loss of $300; less any interest I may have earned so as my inclosed letter states; I am not anxious to cash them in if the state of West Virginia can work out a plan that is feasible."—Willard B. Southard, Rice Lake, Wis. (Claim No. 2590)

"If reorganization takes place satisfied to continue with Company."—Joseph A. Rauch, Francis Creek, Wis. (Claim No. 2758)

"I should prefer to have my contract run to maturity rather than take the cash surrender value in the near future. Realizing the matter may be complicated, however,

I expect to accept the settlement agreed upon by others of this state. Nevertheless, I am continuing to make my payments to the trustees of the Company with the hope that a reorganization plan enabling payment of face of contracts may be achieved."—John K. Lanckton, Menomonie, Wis. (Claim No. 2764)

"If insurance setup to be proposed by Fidelity Assurance Association is satisfactory, I wish to take insurance instead of cash and surrender."—H. V. Foshion, Algoma, Wis. (Claim No. 4539)

## AFFIDAVIT OF EMMETT G. HAMPTON

### (Exhibit 114)

(Caption Omitted)

Emmett G. Hampton being first duly sworn on oath deposes and says:

1. That he is an adult resident of the City of Madison, Dane County, Wisconsin, and that he is regularly employed by the Banking Commission of Wisconsin as Supervisor of Credit Unions, and that at the request of the Banking Commission of Wisconsin, he assumed duties as Office Manager in connection with the liquidation of the Wisconsin assets of Fidelity Assurance Association, title to which Wisconsin assets became vested in the Banking Commission of Wisconsin on April 14, 1941, and which liquidation is now in process under the jurisdiction of the Circuit Court for Dane County, Wisconsin.

2. That as such Office Manager he had charge of all of the files and records in said liquidation proceedings affect-

ing Fidelity Assurance Association during the period from May 15, 1941, to August 1, 1941, during which period claims were being filed in said liquidation by Wisconsin contract holders of Fidelity Assurance Association.

3. That while acting as such Office Manager, he conducted correspondence with Wisconsin contract holders relative to claims in said liquidation and discussed with various contract holders, in person or by telephone, questions relating to the liquidation of the Wisconsin assets of Fidelity Assurance Association. Such personal interviews were had with contract holders aggregating to the best of his knowledge and belief between eight hundred and one thousand in number out of the total of approximately fifty-four hundred contract holders who have filed their claims with the Banking Commission of Wisconsin.

4. That a majority of said contract holders with whom he discussed these matters voluntarily expressed their entire satisfaction with the proceedings as conducted by the Banking Commission of Wisconsin and that it was their express desire that these proceedings should be continued and that in the event efforts should be made to have their claims adjusted in a Federal Court in bankruptcy or re-organization proceedings that it was their desire that the Banking Commission of Wisconsin make every effort to resist any such attempt to so adjust their rights and to continue the proceedings under the supervision of the Banking Commission and the Circuit Court for Dane County, Wisconsin; that these contract holders fully understood that the expenses of the liquidation conducted by the Banking Commission of Wisconsin would necessarily be paid out of the assets on deposit in Wisconsin for their benefit but that

they nevertheless were of the firm belief that the proceedings in Wisconsin should be continued.

5. That a great majority of said contract holders volunteered the information that they had purchased their contracts upon express assurance received from the salesman of Fidelity Assurance Association that the Association had on deposit with the State Treasurer of Wisconsin a sum equal to 110% of the Cash Value of Wisconsin contracts and that such sum was segregated apart from the other assets of the Association for the express benefit of Wisconsin contract holders; that a number of such contract holders further stated that prior to their purchase of the contracts they had checked the salesman's statements in this regard with the Banking Commission of Wisconsin and had ascertained that such was in fact the case; that a great majority of said contract holders further volunteered the information that they were not interested in any reorganization plan which would affect their rights against Fidelity Assurance Association but were now desirous of realizing the present value of their contracts as soon as possible; that of all of the contract holders with whom he discussed matters affecting their claims against Fidelity Assurance Association, only one suggested that he might be in favor of a reorganization of the company and then only if a reorganization would produce more than the present value of his contract.

6. That from his contact with said Wisconsin contract holders, affiant is convinced that any attempts to secure the continuance of payments by such contract holders to Fidelity Assurance Association upon a possible reorganization of said Association would fail, the overwhelming sentiment of such contract holders being that they desire to sever their relationship with Fidelity Assurance Association.

Dated at Madison, Wisconsin, this 10th. day of September, 1941.

Emmett G. Hampton
Supervisor of Credit Unions
State Banking Department

Subscribed and sworn to before me
this 11th day of Sept., 1941.

Lucille Mueller
Notary Public, Dane County, Wisconsin
My Commission Expires: July 2, 1944.

# STATUTES OF IOWA, INSOFAR AS PERTINENT TO THE ISSUES IN THIS CASE, TO WHICH FIDELITY ASSURANCE ASSOCIATION WAS AND IS SUBJECT

## Chapter 392

## Sale of Stock on Installment Plan

**8517 Terms defined.** The term "association" when used in this chapter shall mean any person, firm, company, partnership, association, or corporation, other than building and loan associations and insurance companies and associations, which issue stocks on the partial payment or installment plan. The term "issue," shall mean issue, sell, place, engage in or otherwise dispose of or handle. The term "stock" shall mean certificates, memberships, shares, bonds, contracts, debentures, stocks, tontine contracts, or other investment securities or agreements of any kind or character issued upon the partial payment or installment plan.

**8518 Certificate—how obtained.** No association contemplated by this chapter shall issue any stock until it shall have procured from the commissioner of insurance a certificate of authority authorizing it to engage in such business. To procure such certificate of authority it shall be necessary for such association to file with the commissioner of insurance a statement, under oath, showing the name and location of such association, the name and post-office address of its officers, the date of organization, and if incorporated a copy of its articles of incorporation, also, a copy of its bylaws or rules by which it is to be governed, the form of its certificates, stocks, or contracts, all printed matter issued by it, together with a detailed statement of its financial condition and such other information concerning its affairs or plan of business as the commissioner of insurance may require.

**8519 Approval by commissioner.** If the commissioner of insurance is satisfied that the business is not in violation of law or of public policy, and is safe, reliable, and entitled to public confidence, and shall approve the form of certificate of stock or contract, he shall issue to such association a certificate of authority authorizing it to transact business within this state until the first day of March next succeeding the date of such authorization.

**8520 Annual report.** During the month of January of each year, every association transacting the business contemplated by this chapter, shall file with the commissioner of insurance a statement showing its condition on the thirty-first day of December preceding. Said statement shall be in such form as shall be prescribed by the commissioner of insurance. If it appears from such statement that such association is doing a safe business and is solvent, the commissioner of insurance may renew its certificate of authority authorizing it to transact business within the state until the first day of March of the following year. If at any time it shall appear that such association is doing an unsafe business or is insolvent the commissioner of insurance may revoke its certificate of authority authorizing it to transact business within the state until the first day of March of the following year. If at any time it shall appear that such association is doing an unsafe business or is insolvent the commissioner of insurance may revoke its certificate of authority to transact business and having revoked the certificate of authority of an association organized under the laws of this state, he shall report his action to the attorney general who shall at once apply to the district court or a judge thereof for the appointment of a receiver to close up the affairs of such association, and an injunction may issue in the same proceeding enjoining and restraining the association from transacting business in this state.

**8521 Bonds or securities deposited.** Before any association shall be authorized to transact business contemplated by this chapter, it shall deposit with the commissioner of insurance a bond approved by the commissioner of insurance, guaranteeing the faithful performance of all contracts entered into by such association or securities of the kind designated in subsections 1, 2, 3, 4, and 5 of section 8737, or such other securities as shall be approved by the commissioner of insurance in the amount of twenty-five thousand dollars, which amount shall remain in possession of the commissioner of insurance until the end of the calendar year in which the association shall first be authorized to transact business. At the end of such calendar year, such association shall deposit with the commissioner of insurance securities of the kind above provided in an amount equal to all its liabilities to persons residing within this state and shall keep such deposit at all times equal to such liability; provided that at no time shall such deposit be reduced below twenty-five thousand dollars except at such time as such association shall be by law closing out its business and its liabilities shall have been reduced below twenty-five thousand dollars.

**8522 Unauthorized companies—penalty.** Any member or representative of any association who shall attempt to issue or sell any stock as contemplated by this chapter or to transact any business whatsoever in the name of or on behalf of such association, not authorized to do business within this state, or which has failed or refused to comply with the provisions of this chapter, or has violated any of its provisions shall be deemed guilty of a misdemeanor and on conviction thereof shall be punished by imprisonment in the county jail not to exceed one year, or by a fine of not less than one hundred nor more than ten hundred dollars or by both such fine and imprisonment in the discretion of the court.

**8524 Examination.** Every such association doing business within this state, shall be subject to examination in the same manner as is provided for the examination of insurance companies and shall pay the same fees and costs therefor, and shall so far as is consistent with the plan of business, be subject to the same restrictions and regulations. Such examinations shall be full and complete and in making the same the commissioner of insurance or examiner shall have full access to and may demand the production of all books, securities, papers, moneys, etc., of the association under examination, and may administer oaths, summon and compel the attendance and testimony of any persons connected with such association. If upon such examination, it shall appear that such association does not conduct its business in accordance with law, or if it permits forfeiture of payments by persons holding its stock, after three years from the issuance of said stock or provides for the payment of its expenses other than from earnings, or that any profits, advantage, or compensation of any form or description is given to any member or investor over any other member or investor of the same class, or if beneficiaries are selected or determined or advantages given one over another by any form of chance, lottery, or hazard, or if certificates of stock are by their terms or by any other provision to be redeemed in numerical order or by any arbitrary order or precedence, without reference to the amount previously paid thereon by the holder thereof, or that the affairs are in an unsound condition, or if such association refuses such examination to be made, the commissioner of insurance may revoke its certificate of authority to do business in this state, and having revoked the certificate of authority of an association organized under the laws of this state, he shall report the same to the attorney general, who shall proceed as provided in section 8520.

## Chapter 393.1

## Iowa Securities Act

**8581.02 Administration.** The administration of the provisions of this chapter shall be vested in the commissioner of insurance of the state of Iowa.

The commissioner of insurance shall appoint a superintendent in charge of the securities department and may appoint one or more assistants. The superintendent appointed under this chapter shall perform such duties as the commissioner of insurance shall generally or specifically direct. In case of vacancy in the office of commissioner of insurance, by reason of absence, physical disability or other cause, to administer properly the provisions of this chapter, the superintendent appointed under this chapter shall act for and in the stead of the commissioner of insurance, and thereupon the superintendent shall have generally, for the time being, all the power and authority of this chapter conferred upon the commissioner of insurance.

**8581.06 Registration of securities.** No securities except of a class exempt under any of the provisions of section 8581.04 or unless sold in any transaction exempt under any of the provisions of section 8581.05 shall be sold within this state unless such securities shall have been registered by qualification as hereinafter defined. Registration of stock shall be deemed to include the registration of rights to subscribe to such stock if the application under section 8581.07 for registration of such stock includes a statement that such rights are to be issued.

* * *

**8581.07 Registration by qualification.** All securities required by this chapter to be registered before being sold in this state shall be registered only by qualification in the manner provided by this section.

The commissioner of insurance shall receive and act upon applications to have securities registered by qualification, and may prescribe forms on which he may require such applications to be submitted. Applications shall be in writing and shall be duly signed by the applicant and sworn to by any person having knowledge of the facts, and filed in the office of the commissioner of insurance and may be made either by the issuer of the securities for which registration is applied or by any registered dealer desiring to sell the same within this state.

The commissioner of insurance may require the applicant to submit to him the following information respecting the issuer and such other information as he may in his judgment deem necessary to enable him to ascertain whether such securities shall be registered pursuant to the provisions of this section:

* * *

The commissioner of insurance shall have power to place such conditions, limitations and restrictions on any registration as may be necessary to carry out the purposes of this chapter and the conditions, limitations and restrictions, if any, shall be entered in the register of securities or an entry shall be made in the register of securities referring to a formal order of the commissioner of insurance on file showing such conditions, limitations and restrictions.

* * *

If upon examination of any application the commissioner of insurance shall find that the sale of security referred to therein would not be fraudulent or would not work or tend to work a fraud upon the purchaser, or that the enterprise or business of the issuer is not based upon unsound business principles, he shall record the registration of such security in the register of securities, and thereupon such security so registered may be sold by the issuer or by any registered dealer, subject, however, to the further order of the commissioner of insurance as hereinafter provided.

So long as any security is sold or offered for sale pursuant to registration by qualification under this section, there shall be filed with the commissioner of insurance, each year, within ninety days after the termination of the fiscal year of the issuer of such security, a statement properly verified, which statement shall set forth the financial condition, the amount of assets and liabilities and such other information concerning the financial affairs or the plan of business of the issuer as the commissioner of insurance may require in order to determine whether the continued sale of such securities would result or tend to result in fraud; provided, however, that any applicant for registration by qualification may file with the commissioner of insurance a verified statement that applicant will make no further original distribution under the registration and one statement of condition as required by this paragraph either concurrently therewith or subsequent thereto and thereafter no statement shall be required under this paragraph.

* * * *

**8581.08 May limit price and commission.** The commissioner of insurance may also limit the price at which the securities, either of par or no par value, may be sold. In case of a sale by or on behalf of an issuer, the commissioner of insurance may allow a commission not to exceed twenty per cent of the sale price, such percentage to include all expenses incidental to such sale, including advertising or any other expense chargeable in any way to the sale of such securities.

**8581.09 Consent to service.** Upon any application for registration under this chapter where the issuer functions or intends to function as a dealer in the manner permitted by section 8581.11 and such issuer is not domiciled in this state, there shall be filed with such application the irrevocable written consent of the issuer that suits and actions, growing out of the violation of any provision or provisions

of this chapter, may be commenced against it in the proper court of any county in this state in which a cause of action may arise or in which the plaintiff may reside, by the service of any process or pleading authorized by the laws of this state, on the commissioner of insurance, said consent stipulating and agreeing that such service of such process or pleadings on such commissioner of insurance shall be taken and held in all courts to be as valid and binding as if due service had been made upon the issuer himself, and said written consent shall be authenticated by the seal of said issuer, if it has a seal, and by the acknowledged signature of any officer of the incorporated or unincorporated association, if it be an incorporated or unincorporated association, duly authorized by resolution of the board of directors, trustees or managers of the corporation or association, and shall in such case be accompanied by a duly certified copy of the resolution of the board of directors, trustees or managers of the corporation or association, authorizing the officers to execute the same. In case any process or pleadings mentioned in this chapter are served upon the commissioner of insurance, it shall be by duplicate copies, one of which shall be filed in the office of the commissioner of insurance and another immediately forwarded by registered mail to the principal office of the issuer against which said process or pleadings are directed.

**8581.10 Revocation of registration of securities.** The commissioner of insurance may refuse or revoke the registration of any security by entering an order to that effect, with his findings in respect thereto, if after a reasonable notice and a hearing or upon examination into the affairs of the issuer of such security it shall appear that the issuer:

1. Is insolvent; or

2. Has violated any of the provisions of this chapter or any order of the commissioner of insurance of which such issuer has notice; or

3. Has been or is engaged or is about to engage in fraudulent transactions; or

4. Is in any other way dishonest or has made any fraudulent representations in any prospectus or in any circular or other literature that has been distributed concerning the issuer or its securities; or

5. Is of bad business repute; or

6. Does not conduct its business in accordance with law; or

7. That its affairs are in an unsound condition, or

8. That the enterprise or business of the issuer is not based upon sound business principles.

In making such examination the commissioner of insurance shall have access to and may compel the production of all the books and papers of such issuer, and he or the superintendent may administer oaths to and examine the officers of such issuer or any other person connected therewith as to its business and affairs and may also require a balance sheet exhibiting the assets and liabilities of any such issuer or his income statement, or both, to be certified to by a public accountant either of this state or of any other state where the issuer's business is located, approved by the commissioner of insurance.

Whenever the commissioner of insurance may deem it necessary, he may also require such balance sheet or income statement, or both to be made more specific in such particulars as the commissioner of insurance shall point out or to be brought down to the latest practicable date.

If any issuer shall refuse to permit an examination to be made by the commissioner of insurance, it shall be proper ground for refusal or cancellation of registration.

If the commissioner of insurance shall deem it necessary he may enter an order suspending the right to sell securities pending any investigation or hearing, provided that the order shall state the grounds of the commissioner of insurance for taking such action.

Notice of the entry of such order shall be given personally or by telephone, telegraph, or mail to the issuer and every registered dealer who shall have notified the commissioner of insurance of an intention to sell such security.

**8581.14 Revocation of dealers' and salesmen's registrations.** Registration under section 8581.11 may be refused or any registration granted may be revoked by the commissioner of insurance if after a reasonable notice and a hearing the commissioner of insurance determines that such applicant or registrant so registered:

1. Has violated any provision of this chapter or any regulation made hereunder; or

2. Has made a material false statement in the application for registration; or

3. Has been guilty of a fraudulent act in connection with any sale of securities, or has been or is engaged or is about to engage in making fictitious or pretended sales or purchases of any of such securities or has been or is engaged or is about to engage in any practice or sale of securities which is fraudulent or in violation of the law; or

4. Has demonstrated his unworthiness to transact the business of dealer or salesman;

5. Has been convicted of a felony, or any misdemeanor of which an essential element is fraud;

6. Has made any representations or false statements to, or concealed any essential or material fact from, any person in the sale of a security to such person;

7. Has failed to account to persons interested for all money and/or property received;

8. Has not delivered after a reasonable time, to persons entitled thereto, securities held or agreed to be delivered by the dealer or broker, as and when paid, and due to be delivered;

9. Has made or is making misrepresentations of any essentials or material fact to the commissioner of insur-

ance, or has violated a provision of the laws of any foreign state regulating the sale of securities therein;

10. Is insolvent;

11. Is selling or offering for sale securities through any solicitor and agent not registered in compliance with the provisions of this chapter;

12. Has been refused a license in any state, or that any license in any state theretofore granted the applicant or registrant, or any officer, director, member or partner, manager or trustee thereof has been canceled, suspended or withdrawn for fraudulent conduct or violation of the law of such state regulating the sale of securities therein;

13. Is or has been using practices in the sale of securities that work or tend to work a fraud;

14. Has refused to furnish or give pertinent data to the commissioner of insurance;

* * *

It shall be sufficient cause for refusal or cancellation of registration in case of a partnership or corporation or any unincorporated association, if any member of a partnership or any officer or director of the corporation or association has been guilty of any act or omission which would be cause for refusing or revoking the registration of an individual dealer or salesman.

**8581.15 Examinations and insolvency.** The commissioner of insurance may compel every licensed dealer to make a report not later than the tenth of each month of all securities purchased and sold by such dealer and its salesmen during the preceding calendar month, and the books of all dealers, whether they are duly licensed or their license has been suspended, revoked or canceled, shall at all times be open to examination and inspection by the commissioner of insurance or any of his employees or any person delegated to examine them. If, upon examination, it is found that the dealer is insolvent or if the records are in such condi-

tion that the examiner is unable to determine the financial condition of the dealer, the commissioner of insurance may ask the appointment of a receiver to safeguard the interests of the public; the district court in Polk county or the county in which such dealer has its principal place of business shall have authority to appoint such receiver.

**8581.21 Injunctions.** Whenever it shall appear to the commissioner of insurance, either upon complaint or otherwise, that in the issuance, sale, promotion, negotiation, advertisement, or distribution of any securities within this state, including any security exempted under the provisions of section 8581.04, and including and transaction exempted under the provisions of section 8581.05, any person, as defined in this chapter, shall have employed or employs, or is about to employ any device, scheme or artifice to defraud or for obtaining money or property by means of any false pretense, representation or promise, or that any such person shall have made, makes or attempts to make, in this state fictitious or pretended purchases or sales of securities or shall have engaged in, or engages in or is about to engage in any practices or transaction or course of business relating to the purchase or sale of securities which is in violation of law or which is fraudulent or which has operated or which would operate as a fraud upon the purchaser, any one or all of which devices, schemes, artifices, fictitious or pretended purchases or sales of securities, practices, transactions and courses of business are hereby declared to be and are hereinafter referred to as fraudulent practices; or that any person acting as a dealer or salesman within this state without being duly registered as such dealer or salesman as provided in this chapter, the commissioner of insurance may:

• • •

2. Examine the promoter, seller, broker, dealer, negotiator, advertiser or issuer of any such securities, and any agents, employees, partners, officers, directors, mem-

bers or stockholders thereof, under oath; and examine such records, books, documents, accounts and papers as may be relevant or material to the inquiry. For this purpose the commissioner of insurance shall have power to require by subpoena the attendance and testimony of witnesses and the production of papers, and the commissioner of insurance may sign subpoenas, administer oaths, and affirmations, examine witnesses and receive evidence. The fees and mileage shall be the same as prescribed by law in judicial procedure in the courts of this state in civil cases. Any party to any hearing before the commissioner of insurance, shall have the right to the attendance of witnesses in his behalf at such hearing, upon making a request therefor to the commissioner of insurance and designating the person or persons sought to be subpoenaed.

* * *

5. Whenever it shall appear to the commissioner of insurance from any report or statement filed, from any examination made as provided for in this chapter, or from any other source that any person, as defined in this chapter, has engaged in, is engaged in or is about to engage in any practice declared to be illegal and prohibited by the chapter, or that it will be against public interest for any person, as defined in this chapter, to issue, sell, offer for sale, purchase, offer to purchase, promote, negotiate, advertise or distribute any securities within or from this state, he may by petition apply to a court of equity for a writ of injunction or the appointment of a receiver, or both. The said petition shall allege that it appears to the commissioner of insurance from an investigation made in accordance with the provisions of this chapter, that such person, as defined in the chapter, is engaged in or is about to engage in practices declared to be illegal and prohibited or that it is against public interests for such person, as defined in this chapter, to issue, sell, offer for sale, purchase, offer to purchase, promote, negotiate, advertise or distribute any securities within

or from this state, which allegations may be verified generally, and on the filing of said petition the court may issue an injunction restraining such person from continuing such practices or engaging therein or doing any acts in furtherance thereof and/or the court may issue an injunction restraining the issuance, sale, offer for sale, purchase or offer to purchase, promotion, negotiation, advertisement, or distribution within or from this state, of any securities by such person and any agents, employees, brokers, partners, officers, directors or stockholders thereof, until the court shall otherwise order.

(Other portions of Chapter 393.1 omitted as not pertinent.)

## Chapter 386

### Permits To Foreign Corporations

**8420. Application for permit.** Any corporation for pecuniary profit organized under the laws of another state, or of any territory of the United States, or of any foreign country, which has transacted business in the state of Iowa since September 1, 1886, or desires hereafter to transact business in this state, and which has not a permit to do such business, shall file with the secretary of state a certified copy of its articles of incorporation, duly attested by the secretary of state or other state officer in whose office the original articles were filed, accompanied by a resolution of its board of directors or stockholders authorizing the filing thereof, and also authorizing the service of process to be made upon any of its officers or agents in this state engaged in transacting its business, and requesting the issuance to such corporation of a permit to transact business in this state: said application to contain a stipulation that such permit shall be subject to the provisions of this chapter.

**8421. Details of application—secretary of state as process agent.** Said application shall also contain a statement subscribed and sworn to by at least two of the principal officers of the corporation, setting forth the following facts, to-wit:

1. The total authorized capital of the corporation.
2. The total paid up capital of the corporation.
3. The total value of all assets of the corporation, including money and property other than money represented by capital, surplus, undivided profits, bonds, promissory notes, certificates of indebtedness or other designation, whether carried as money on hand or in bank, real estate or personal property of any description.
4. The total value of money and all other property the corporation has in use or held as investment in the state, at the time the statement is made (if any).
5. The total value of money and all other property the corporation proposes or expects to make use of in the state, during the ensuing year.
6. Certified copy of the resolution of the board of directors of said corporation giving name and address in Iowa of a resident agent on whom the service of original notice of civil suit in the courts of this state may be served. Failing which, or in the event such agent may not be found within the state, service of such process may then be made upon said corporation through the secretary of state by sending the original and two copies thereof to him, and on the original of which he shall accept service on behalf of said corporation, retain one copy for his files and send the other by registered mail to the corporation at the address of its home office as shown by the records in his office, which service shall have the same force and effect as if lawfully made upon said corporation within the county where such civil suit could be maintained against it under the laws of this state.

§422. **Secretary of state to determine values.** The secretary of state can make such independent and further investigation as to the property within this state owned by any such corporation as he may desire, and upon the true facts determine the value thereof, and fix the fee to be paid by such company.

(Other portions of Chapter 386 omitted as not pertinent.)

## DECREE AND ORDER OF DISTRICT COURT, POLK COUNTY, IOWA, APPOINTING PERMANENT RECEIVER

**(Part of Ex. 121)**

(Caption Omitted)

Now on this 19th day of May, A. D., 1941, the same being one of the regular days of the May 1941 term of said Court, this matter comes on for final hearing before the Honorable John J. Halloran, one of the Judges of the above named Court, upon the application and petition of G. R. Shaw for the appointment of a receiver for the above named Company, the answer and cross-petition of the defendant and intervenor Chas. R. Fischer, Commissioner of Insurance of the State of Iowa, for the appointment of a permanent receiver, the petition of the State of Iowa through its Attorney General John M. Rankin for the appointment of a permanent receiver, and the petition of intervention of E. G. Pullen for the appointment of a permanent receiver. Plaintiff's proof of service of notice upon the defendant corporation and upon H. Isaiah Smith, one of the receivers appointed by the Circuit Court, Kanawha County, State of West Virginia, for the defendant

corporation, are thereupon submitted, and the Court finds that on the 24th day of April, A. D., 1941, this Court entered an order appointing Chas. R. Fischer, Commissioner of Insurance of the State of Iowa, receiver pendente lite, and fixing the 10th day of May, A. D., 1941, at 9:00 o'clock, A. M., at the Court House in Des Moines, Polk County, Iowa, before the Honorable John J. Halloran, as the date, time, and place of hearing upon the application and petition for the appointment of a permanent receiver for said defendant corporation and its assets within the State of Iowa, and to show cause why its affairs and business in the State of Iowa should not be wound up and its assets distributed to Iowa creditors as by law provided, and that said order further provided that notice of the date, time, and place of hearing upon the application and petition for the appointment of a permanent receiver should be given by personal service upon the defendant corporation and upon the parties named in said order, and that notice was given to the defendant corporation and upon H. Isaiah Smith, one of the receivers appointed by the Circuit Court of Kanawha County, State of West Virginia, the state of the said defendant corporation's domicile, as provided for in said order.

The plaintiff, G. R. Shaw, and the intervenor, E. G. Pullen, appear now by their attorneys Carl J. Stephens and Ben C. Buckingham, the intervenor, State of Iowa by its Attorney General John M. Rankin and Asst. Attorney General Floyd Philbrick, and that the defendant-cross-petitioner Chas. R. Fischer, Commissioner of Insurance of the State of Iowa, appears by Attorney General John M. Rankin and Asst. Attorney General Floyd Philbrick, and that the

defendant, Fidelity Assurance Association, appears not and its default is hereby entered against it.

And the Court having examined the files in said cause, the notices and the return of service thereon, and having examined the evidence submitted, heard the statements of counsel, and being fully advised in the premises, FINDS:

That the defendant corporation is a corporation organized and existing under and by virtue of the laws of the State of West Virginia, engaged in the business, among other things, of offering for sale and selling installment and annuity investment contracts;

That on or about the 11th day of April, 1941, upon complaint of E. G. Sims, Auditor of State of the State of West Virginia, and ex-officio Insurance Commissioner of said state, an order was entered by the Circuit Court of Kanawha County, State of West Virginia, finding that said defendant corporation was insolvent and was unable to meet its matured and maturing obligations and to pay its creditors, and that the further continuance of its business would be hazardous to the best interests of its contract holders, creditors, and the public, and that it was necessary for the preservation of the property and assets of said defendant corporation and of the respective rights of its creditors and stockholders that the same should be administered through a receiver or receivers, and ordering and decreeing the appointment of H. Isaiah Smith and Ross B. Thomas Receivers of said defendant corporation and of its property and assets, and that the said H. Isaiah Smith and Ross B. Thomas are the duly appointed, qualified, and acting receivers in the State of West Virginia of said defendant corporation;

That the defendant corporation was, upon its application and order of the Executive Council of the State of Iowa entered on the 7th day of January, 1929, issued a certificate of authority by the Auditor of State of the State of Iowa pursuant to the provisions of Chapter 392, Code of Iowa, 1927, authorizing it to engage in the business in the State of Iowa of offering for sale and selling installment and annuity investment contracts to persons residing within the State of Iowa;

That pursuant to the provisions of said Chapter 392, the defendant corporation, as a condition precedent to the issuance of certificate of authority and its engaging in business in the State of Iowa, deposited with the Auditor of State of the State of Iowa securities in the amount of Twenty-five Thousand ($25,000) Dollars, guaranteeing the faithful performance of contracts sold by it to persons residing in Iowa, and that since said original deposit it has supplemented the same and maintained said deposit in an amount equal to all of its liability to Iowa contract-purchasers and now has on deposit with the Commissioner of Insurance of the State of Iowa, pursuant to the provisions of Chapter 392, Code of Iowa, 1927, as amended by the Acts of the 48th General Assembly, securities of the par value of Forty-two Thousand ($42,000) Dollars;

That said defendant corporation, according to the evidence submitted, has a present liability to Iowa contract purchasers approximating somewhere between Thirty-five Thousand ($35,000) Dollars and Forty-five Thousand ($45,000) Dollars;

That the defendant corporation filed application with the Secretary of State, State of Iowa, on or about the 17th

day of December, 1937, for qualification as a foreign corporation under and pursuant to the provisions of Chapter 386, Code of Iowa, 1931, and that permit was issued by the Secretary of State to said corporation;

That with its said application it filed resolution of its board of directors designating Walter L. Keck, Maquoketa, Iowa, as its resident agent, and consenting to the service of process on him pursuant to the provisions of said Chapter 386, and that the said Walter L. Keck is now the resident agent of said defendant corporation;

That the defendant corporation did on or about the 28th day of March, 1930, file its application with the Secretary of State of the State of Iowa, for registration of securities as an issuer-dealer of securities pursuant to and in compliance with the provisions of the Iowa Securities Law as contained in Chapter 393, Code of Iowa, 1927, and that pursuant to said application said defendant corporation was authorized to sell in Iowa installment and annuity investment contracts, and that pursuant to said registration and said Chapter 393, Code of Iowa, 1927, said defendant corporation did file with the Secretary of State, State of Iowa, its written consent without power of revocation that suits and actions might be commenced against it in the State of Iowa by the service of process upon the Secretary of State of the State of Iowa;

That said defendant corporation's registration was cancelled sometime during the year 1936 in accordance with the laws of the State of Iowa;

That the said defendant corporation did sell its installment annuity investment contracts to persons residing in Iowa, and that the plaintiff, G. R. Shaw, and the intervenor,

E. G. Pullen, are contract holders as alleged in the plaintiff's petition and the said intervenor's petition, and that each, as well as other Iowa contract purchasers, has an interest in the assets of the defendant corporation now on deposit with the defendant-cross-petitioner Chas. R. Fischer, Commissioner of Insurance of the State of Iowa, and that said deposit constitutes a trust fund for the benefit of said plaintiff, intervenor and other Iowa contract purchasers;

That Chas. R. Fischer, Commissioner of Insurance of the State of Iowa, was, pursuant to the order of this Court entered on the 24th day of April, A. D., 1941, appointed receiver pendente lite of the defendant corporation and its assets located and situated within the State of Iowa, and that the said Chas. R. Fischer qualified as such receiver by filing surety bond approved by the Clerk of this Court and by taking his oath on the 24th day of April, 1941, and now has in his possession as such the securities deposited by said defendant corporation with him as Commissioner of Insurance of the State of Iowa, pursuant to the provisions of Chapter 392, Code of Iowa, 1939;

That the defendant corporation is insolvent, and that the further continuance of its business in the State of Iowa would be hazardous to its contract purchasers, creditors, and the public, and that a permanent receiver should be appointed for said defendant corporation in the State of Iowa as prayed to take charge and possession of its assets situated within the State of Iowa for the purpose of winding up the affairs and business of said defendant corporation, and for the purpose of distributing the same to the Iowa contract purchasers for whose benefit said assets were deposited in accordance with the provisions of Chapter 392,

Code of Iowa, 1939, and such other creditors as may by the laws of this state be entitled to the same;

That this Court has jurisdiction to appoint a permanent receiver for the defendant corporation, and its assets located in the State of Iowa, and to grant the relief prayed for by the parties to this cause of action.

NOW, THEREFORE, IT IS FINALLY ORDERED, ADJUDGED AND DECREED:

That under and pursuant to the statutes and laws of this state that the business and affairs of the defendant, Fidelity Assurance Association, in the State of Iowa be dissolved, closed up, and its assets situated within the State of Iowa administered and distributed in accordance with the laws of this state to Iowa contract purchasers of the defendant corporation, and such others as may be entitled to the same;

That Chas. R. Fischer, Commissioner of Insurance of the State of Iowa, be, and he is hereby appointed permanent receiver of said defendant corporation in accordance with the statutes and laws of this state with authority and direction to take charge of and manage the property, assets, and business of the defendant corporation within the State of Iowa with full power to sue for, collect, receive, and take into his possession the goods, chattels, rights, credits, moneys, books, papers, property and assets of every description and wherever stiuated in the State of Iowa of the defendant corporation, and to do any and all acts and things which may be necessary, proper, or advisable to preserve the property, assets, rights and privileges of the defendant corporation, and with all the incidental powers ordinarily vested in receivers in like cases;

That said receiver shall, as soon as it may be practicable, file an inventory of all property of every description that shall have come into his possession as such receiver;

That said receiver be, and he is, hereby directed to proceed to wind up the business of the defendant corporation in the State of Iowa and to that end all installment annuity investment contract purchasers and creditors, including all lien and unsecured creditors of the defendant and all claimants to specific assets in the hands of the receiver, be, and they hereby are ordered to file proof of their claim with the Clerk of the District Court on or before the 20th day of August, A. D., 1941;

That every proof of claim shall be itemized and sworn to and shall state the particularity, nature, and origin of the claim so asserted, the actual consideration therefor, when the same has become or will become due, whether any or what securities are held, whether any or what payments have been made thereon, and the sum claimed is justly due, and that the claimant has not, nor has any other persons for his use, received any security or satisfaction whatever, other than by him set forth;

That said receiver shall, within thirty (30) days from the date hereof, give notice to creditors of the defendant corporation advising them with respect to filing of claim, the powers of receiver with respect thereto, as herein set forth, and the time within which all claims shall be filed, by publishing the same in at least three newspapers of general circulation in the State of Iowa once each week for two consecutive weeks, the first publication thereof to be not later than the 3rd day of June, A. D., 1941;

That said receiver is authorized to examine the claims so filed, as heretofore provided, and to make his findings

thereon allowing or disallowing, in whole or in part, each and all of said claims, and to file in this cause as soon as possible after the time for filing claims has expired written report setting forth for the confirmation of this Court the results of such findings, subject to the right of any claimant to object to any findings so made, such objection to be filed in writing in this cause at such time as the Court may hereafter prescribe;

That in the event that any creditor, creditors, or claimants shall not so present or file their claims with the receiver aforesaid on or before the 20th day of August, A. D., 1941, it is hereby ordered that they shall be debarred from participating in any dividend or distribution that may hereafter be made in these proceedings, or from any interest in and to the assets of the defendant corporation administered by the receiver or any proceeds derived from the sale or other distribution thereof;

That the receiver be, and he is, hereby directed to cause all of the assets of the defendant corporation located within the State of Iowa, and coming into his hands as said receiver, to be appraised by two (2) competent appraisers whom the receiver shall select, and who shall report to this Court before any sale is made of the same and findings with respect to the value of the assets so appraised;

That the receiver be, and he is, further authorized and directed to sell all of the assets of the defendant corporation situated within the State of Iowa, and coming into his hands as said receiver, at either private or public sale, free and clear of all liens and encumbrances, but subject, however to the expenses of the receivership and the costs;

That the receiver be, and he is, hereby authorized to

employ Carl J. Stephens and his associate, Ben C. Buckingham, as counsel to advise him in the performance of his duties as receiver, and that he shall have leave to employ such agents or employees as may be necessary to enable him to properly perform his duties as said receiver;

That the said Chas. R. Fischer before entering upon his duties herein shall take an oath and file a bond with the Clerk of this Court as receiver, which bond shall be in the sum of $10,000.00, with sureties to be approved by the Clerk of this Court, conditioned that said receiver shall well and truly perform the duties of his office; whereupon letters of receivership shall issue to him;

That the said Chas. R. Fischer shall file his report as receiver pendente lite with this Clerk, and upon approval thereof he shall stand discharged as receiver pendente lite;

That the title to the assets deposited by the defendant corporation pursuant to the provisions of Chapter 392, Code of Iowa, 1927, vested at the time and times said securities were deposited and were at the time of the appointment of the receivers for the defendant corporation by the Circuit Court of Kanawha County, State of West Virginia, and at the time of the appointment by this Court of Chas. R. Fischer, as receiver pendente lite of the defendant corporation, held by the said Chas. R. Fischer, Commissioner of Insurance of the State of Iowa, in trust for the benefit of contract purchasers of said defendant corporation residing in Iowa, and that the title to said deposited securities be, and the same is, hereby vested in the said Chas. R. Fischer as permanent receiver of said defendant corporation for the benefit of the contract purchasers for whom the same were deposited to be distributed in accordance with

this order and decree and the subsequent orders of this Court;

That the findings of this Court, as herein contained, be, and the same are, hereby made a part of the order and decretal portion of this order and decree with the same force and effect as if specifically set out therein;

That this Court retains jurisdiction of this cause for the purpose of giving such further directions and the granting and entering of such orders, supplemental orders or decrees as may be necessary and proper in connection with the winding up of the affairs and business of the defendant corporation within the State of Iowa, and the administration and distribution of the assets of said defendant corporation situated within the State of Iowa, and coming into the hands of the receiver.

John J. Halloran

JUDGE, NINTH JUDICIAL DISTRICT OF IOWA

## STATES, INCLUDING TERRITORIES OF ARIZONA AND NEW MEXICO, WHICH IN 1910 OR PRIOR THERETO CLASSIFIED LIFE INSURANCE COMPANIES AS SUCH BY REASON OF THE WRITING OF LIFE INSURANCE POLICIES AND THE PURCHASE AND SALE OF ANNUITIES

### Territory of Arizona

"797. (Sec. 37.) Every corporation formed under the laws of this territory for the purpose of mutual insurance on the lives or health of persons, or against accidents to persons for life or any fixed period of time, or to purchase and sell annuities, must have a capital stock of not less than one hundred thousand dollars. * * *."

Revised Statutes of Arizona (1901) Title 13, Ch. 3, Insurance Corporations, sec. 797.

### California

"594. Insurance classified. All insurance business in the State of California is hereby classified in the following sixteen kinds, namely:

"[Life insurance.] 1. Life insurance, including within its meaning insurance upon the lives of persons and every insurance appertaining thereto, and the granting, purchasing and disposing of annuities.

"* * *"

(The section was first enacted in substantially the form set out by Stats. and Amdts. 1907, 141.)

Kerr's Cumulative Supplement (1906-1913) California Political Code.

### Colorado

"3116. Purposes of organization.

"Sec. 30. It shall be lawful for any insurance company organized under the laws of this state:

"* * *

"Second: To make insurance upon the lives of persons and every insurance appertaining thereto or connected therewith, including health and accident insurance, and to grant, purchase or dispose of annuities."

Courtright's Colorado Statutes (1908) p. 1140. (Laws 1907, p. 451.)

**Connecticut**

Sec. 3540 "Annuities may be issued by companies. Insurance companies chartered by and doing business in this state, and empowered to make contracts contingent upon life, may grant and issue annuities either in connection with or separate from contracts of insurance predicated upon life risks; and all such annuities heretofore issued by such companies shall be valid."

General Statutes of Connecticut (1902).

**Illinois**

"177. Number of persons who may organize, etc.] Sec. 1a. Any number of persons, not less than nine, may organize an incorporated company to make insurance upon the lives of persons, and every insurance pertaining thereto, or connected therewith, and to grant or dispose of annuities."

Revised Statutes of Illinois, Hurd (1909) Ch. 73, Insurance, sec. 177.

**Indiana**

"4678. Life Insurance—Stock or mutual plan.—1. That any ten or more persons, citizens of this state, may associate in accordance with the provisions of this act, and form an incorporated company for the following purposes: To make insurance, either upon the stock or mutual prin-

ciple, upon the lives of individuals, and every insurance appertaining thereto or connected therewith, and to grant and purchase annuities."

Burns' Annotated Indiana Statutes, Revision of 1908, Vol. 2, sec. 4678.

### Kansas

"4111. Charter of life insurance company; by-laws, etc. Sec. 43. Every company or coporation formed or organized pursuant to chapter 23 of the General Statutes of 1868 for the purpose of making insurance on the lives of individuals shall file in the office of superintendent of insurance a copy of its charter, duly certified by the secretary of state, and it shall also file a copy of its by-laws, which shall set forth the number of its directors or trustees, which shall not be less than five nor more than twenty-five, and the manner of electing the same, and their term of office respectively, a majority of whom shall be citizens of this state, the times of holding elections, and the manner of filling vacancies. And every such company shall thereafter have power to make insurance on lives of individuals, and every assurance pertaining thereto or connected therewith, and to grant, purchase and dispose of annuities and endowments of every kind and description whatever. [L. 1871, ch. 93, sec. 44; March 24.]"

General Statutes of Kansas, Dassler, (1909), sec. 4111.

### Kentucky

"4366. Any number of persons, not less than thirteen, may associate and form a corporation to (make) insurance upon the lives of individuals, and every insurance appertaining thereto, or connected therewith, and to grant, purchase or dispose of annuities and endowments of any kind." (Act April 5, 1893.)

Statutes of Kentucky, Russell (1909) Life Insurance and Life Insurance Companies, Art. 7, sec. 4366.

## Louisiana

"3563. [Sec. 1, Act 203, 1908, p. 301.] It shall be lawful for any number of persons, not less than fifteen, citizens of the United States, and residents of this State on compliance with the provisions following, to form insurance companies on the stock plan, for any of the following purposes, to wit:

"* * *

"Third. To insure the lives or the health of persons, and every insurance appertaining thereto, and to grant, purchase or dispose of annuities."

Marr's Annotated Revised Statutes of Louisiana, Vol. 2, p. 1217.

## Maryland

"148. Every corporation formed under the provisions of this article for the purposes of life insurance is hereby authorized also to insure individuals against accident, and to grant, purchase or dispose of annuities, unless it be otherwise provided in its charter or by-laws."

Public General Laws of Maryland, (1904) Vol. I, Art. 23, sec. 148.

## Massachusetts

"Section 118. All companies doing business in the commonwealth under any charter, compact, agreement or statute of this or any other state, involving the payment of money or other thing of value to families or representatives of policy and certificate holders or members, conditioned upon the continuance or cessation of human life, or involving an insurance, guaranty, contract or pledge for the payment of endowments or annuities, shall be deemed to be life companies, and shall not make any such insurance, guaranty, contract or pledge in the commonwealth, or to or with any resident thereof, which does not distinctly state

the amount of benefits payable, the manner of payment and the consideration therefor, nor any such insurance, guaranty contract or pledge the performance of which is contingent upon the payment of assessments made upon survivors. * * *." (Acts & Resolves of Massachusetts 1907, ch. 576, sec. 66,)

General Laws of Massachusetts (1921) Vol. 2, Ch. 175, sec. 118.

## Michigan

"(9323) Section 1. Thirteen or more persons may become a corporation for the purpose of making any of the following kinds of insurance:

First, Upon the lives and health of persons and every insurance pertaining thereto, and to grant, purchase or dispose of annuities; * * *." (Act 77, 1869, p. 124.)

Compiled Laws of Michigan, (1915) Vol. 2, p. 3375.

## Minnesota

"1687 Defined—Every corporation or association, domestic or foreign, operating upon any plan involving payment of money or other thing of value to policy or certificate holders, or members, or families, or representatives of either, conditioned upon the continuance or cessation of human life, or for the payment of endowments or annuities (except benevolent, fraternal, cooperative, or secret societies or orders for the sole purpose of mutual welfare, protection, and relief of their members, and the payment of stipulated amounts, or the proceeds of assessments, to the families of deceased members), shall be deemed a life insurance company, and shall make no such insurance, guaranty, contract, or pledge in this state, or to or with any citizen or resident thereof, which does not distinctly specify the amount and manner of payment of benefits and the consideration therefor. ('95 c. 175 s. 63; '01 c. 143)"

Revised Laws of Minnesota (1905) sec. 1687.

## Mississippi

"2598 (2339) Life insurance companies defined.—All corporations, associations, partnerships or individuals doing business in this state under any charter, contract, agreement or statute, of this or any other state, involving the payment of money or other things of value to families or representatives of policy and certificate holders or members, conditioned upon the continuance or cessation of human life, or involving an insurance, guaranty, contract or pledge for the payment of endowments or annuities, or who shall employ agents to solicit such business, shall be deemed to be life insurance companies and shall in all respects be subject to the laws herein made and provided for the government of life insurance companies, and shall not make any such insurance, guaranty, contract or pledge in this state with any citizen or resident thereof which does not distinctly state the amount of benefits payable, the manner of payment and the consideration therefor."

Mississippi Code (1906) sec. 2598.

## Missouri

"Sec. 6895. Purposes for which formed.—Any number of persons, not less than thirteen, may associate and form a company for the purpose of making assurance upon the lives of individuals, and every assurance pertaining thereto or connected therewith, and to grant, purchase and dispose of annuities and endowments of every kind and description whatsoever, and to provide an indemnity against death; and for weekly or other periodic indemnity for disability occasioned by accident to the person of the insured; but such accident insurance shall be made a separate department of the business of the life insurance company undertaking it."

Revised Statutes of Missouri (1909) Vol. 2, sec. 6895.

## Montana

"4016. *Definitions and classifications.*—Corporations, Associations, and Societies organized to do the following described business are insurance corporations within the meaning of this Act.

"* * *

"Second: To insure the lives and health of persons and to grant, purchase or dispose of annuities."

Revised Codes of Montana (1907) sec. 4016.

## New Jersey

"1. Insurance companies; incorporation; purposes.—Ten or more persons may become a corporation for the purpose of making any of the following kinds of insurance, to wit:

"* * *

"—Life.—III. Upon the lives or health of persons, and every insurance appertaining thereto, and to grant, purchase or dispose of annuities;" (Ch. 134, Laws of New Jersey 1902).

Compiled Statutes of New Jersey (1709-1910) Vol. 2, p. 2838.

## Territory of New Mexico

"Sec. 2846. Insurance Companies—General powers.

"Sec. 46 It shall be lawful for any insurance company to transact business in this State;

"* * *

"Second—To make insurance upon the lives of persons and every insurance appertaining thereto or connected therewith, including health and accident insurance, and to grant, purchase or dispose of annuities.

"* * *

"Act of Mar. 17, '09; L. '09, C. 48, sec. 25."

New Mexico Statutes Annotated (1915) sec. 2846.

## New York

"Sec. 70. Incorporation. Thirteen or more persons may become a corporation for the purpose of making any of the following kinds of insurance:

"1. Upon the lives or the health of persons and every insurance appertaining thereto, and to grant, purchase or dispose of annuities."

Consolidated Laws of New York (1909) Vol. III, Article 2, sec. 70.

## North Carolina

"4773. Life insurance company defined; requisites to contracts. All corporations, associations, partnerships or individuals doing business in this state, under any charter, compact, agreement or statute of this or any other state, involving the payment of money or other thing of value to families or representatives of policy and certificate holders or members, conditioned upon the continuance or cessation of human life, or involving an insurance, guaranty, contract or pledge for the payment of endowments or annuities, or who shall employ agents to solicit business, shall be deemed to be life insurance companies, shall in all respects be subject to the laws herein made and provided for the government of life insurance companies, and shall not make any such insurance, guaranty, contract or pledge in this state with any citizen, or resident thereof, which does not distinctly state the amount of benefits payable, the manner of payment and the consideration therefor."

Revisal of 1905 of North Carolina, Vol. 2, sec. 4773.

## Ohio

"Sec. 3587. Any number of persons, not less than thirteen, may associate and form a company to make insurance upon the lives of individuals, and every insurance apper-

taining thereto or connected therewith, on the mutual or stock plan, and grant, purchase, or dispose of annuities."

Revised Statutes of Ohio (1890) Vol. 1, Ch. 10, sec. 3587.

### Oklahoma

"3404. Incorporation of companies authorized—kinds of insurance classified. Ten or more persons may form a corporation for the purpose of making any of the following kinds of insurance, to-wit:

"* * *

"Third. Upon the lives or health of persons, and every insurance appertaining thereto, and to grant, purchase or dispose of annuities."

Revised Laws of Oklahoma (1910) Vol. I, sec. 3404.

### Oregon

"Sec. 4629. Life Insurance Companies Defined.

"All corporations, associations, partnerships, or individuals doing business in this state under any charter, compact, agreement, or statute of this or any other state, involving the payment of money or other things of value to families or representatives of policy or certificate holders or members conditioned upon the continuance or cessation of human life, or involving an insurance, guaranty, contract, or pledge for the payment of endowments or annuities shall be deemed to be life insurance companies, and shall not make any such insurance, guaranty, contract, or pledge in this state or to or with any citizen or resident thereof, which does not distinctly state the amount of benefits payable, the manner of payment and the consideration therefor, nor any such insurance, guaranty, contract, or pledge the performance of which is contingent upon the payment of assessments made upon survivors; *provided, however*, the provisions of this section shall not relate to or interfere with the provisions of section 4658 and 4659 of this Code. [L. 1907, c. 216, p. 376.]"

Lord's Oregon Laws (1910) Vol. 2, sec. 4629.

## Pennsylvania

"Insurance

"I. Incorporation of insurance companies.

"1. Any ten or more persons, citizens of this Commonwealth, may associate in accordance with the provisions of this act and form an incorporated company for any of the following purposes, to wit:

"* * *

"3. Second. To make insurance either upon the stock or mutual principle, upon the lives of individuals and every insurance appertaining thereto or connected therewith, and to grant and purchase annuities."

Brightly's Digest of Laws of Pennsylvania (1893-1903) p. 342.

## Texas

"Article 4724. Terms defined.—A life insurance company shall be deemed to be a corporation doing business under any charter involving the payment of money or other thing of value, conditioned on the continuance or cessation of human life, or involving an insurance, guaranty, contract or pledge for the payment of endowments or annuities. * * * [Acts 1909, p. 192, sec. 1.]"

Vernon's Sayles' Texas Civil Statutes (1914) Vol. 3, Article 4724.

## Washington

"Section 6123. Number of Incorporators.

"Any number of persons, not less than seven, may incorporate a company to write insurance upon the lives of persons, and every insurance pertaining thereto, or connected therewith, and to grant or dispose of annuities or to write policies of endowment. [L. '09, p. 539, sec. 2.]"

Remington & Ballinger's Annotated Codes and Statutes of Washington, Vol. 2, sec. 6123.

### West Virginia

"Life insurance companies chartered by and doing business in this State, and empowered to make contracts contingent upon life, may grant and issue annuities, either in connection with or separate from contracts of insurance predicted upon life risks, and all such annuities heretofore issued by such companies shall be valid."

West Virginia Code (1909 Supplement) sec. 1107a17.

### Wisconsin

"Section 1897. An insurance corporation may be formed for the following purposes: * * *

"* * *

"(3) Life Insurance.—Upon the lives or health of persons, and every assurance pertaining thereto, and to grant, purchase or dispose of annuities and endowments." Ch. 460, Laws of Wisconsin 1909.

Wisconsin Statutes (1911) sec. 1897.

## STATES WHICH SINCE 1910 HAVE CLASSIFIED LIFE INSURANCE COMPANIES AS SUCH UPON THE BASIS OF THE SALE OF LIFE INSURANCE POLICIES AND ANNUITIES

### Arkansas

"Corporations may be formed or enter this State to effect insurance for the following purposes:

"* * *

"Sec. 7647. Life insurance. Upon the lives or health of persons, and every assurance pertaining thereto, and to grant, purchase or dispose of annuities and endowments."

Digest of Statutes of Arkansas (1937) Pope, Vol. II, sec. 7647.

## Idaho

"40-301. Insurance classified.—All insurance business in this state is classified into fourteen classes, defined by the following sections of this chapter.

"40-304. Class 3-Life.—Life insurance, including endowments and annuities, but not including health or accident or sickness insurance, or any casualty insurance as hereinafter provided."

Idaho Code Annotated (1932) Title 40, secs. 301, 304.

## Iowa

"Annuities. Any life insurance company organized on the stock or mutual plan may grant and sell annuities."

Code of Iowa (1935) Ch. 398, sec. 8673-e1.

## New Hampshire

"1. Purposes. Subject to the additional or varied requirements stated in this chapter, a corporation may be formed, pursuant to the provisions of chapter 225, for the purpose of conducting the following kinds of insurance business:

"III. On the lives of persons and every insurance pertaining thereto or connected therewith, including endowments, and to grant, purchase or dispose of annuities."

Public Laws of New Hampshire (1926) Vol. 2, Ch. 272, sec. 1, III.

## Utah

"Classification of Insurance Business. All insurance business in the state of Utah is hereby classified as follows:

"(1) Life insurance, including within its meaning insurance upon the lives of persons and every insurance ap-

pertaining thereto, and the granting, purchasing and disposing of annuities."

Revised Statutes of Utah (1933) Title 43, Ch. 3, sec. 2 (1).

## Vermont

"General provisions. Subject to the additional or varied requirements stated in this and the eleven following sections, a corporation may be formed pursuant to the provisions of the general corporation law to do any or all insurance and reinsurance comprised in any one of the following numbered subdivisions:

"I. On the lives of persons and every insurance appertaining thereto or connected therewith, including endowments, and to grant, purchase or dispose of annuities;

"* * *"

Public Laws of Vermont (1933), Ch. 277, Insurance Companies, sec. 6911.

## Wyoming

"Life insurance companies defined. All corporations, associations, partnerships, or individuals, doing business in the state under any charter, contract, agreement, or statute of this or of any other state involving the payment of money or other things of value to families or representatives of policy or certificate holders, or members, conditioned upon the continuance or cessation of human life, or involving insurance, guarantee, contract, or pledge for the payment of endowments or annuities, shall be deemed to be life insurance companies, and shall be subject to this article. [L. '21, c. 142, §23.]"

Wyoming Revised Statutes (1931) Ch. 57, sec. 223.

## LETTER, FIDELITY ASSURANCE ASSOCIATION TO BANKING COMMISSION OF WISCONSIN, MARCH 24, 1941

**(Exhibit 67)**

Complying with your request of March 6 for an additional deposit of $51,000 to our account, we are shipping to Treasurer John M. Smith, State Treasury Department, Madison, Wisconsin, $51,000 United States Treasury ¾% Notes due Sept. 15, 1944. It is expected this shipment will go forward tomorrow.

Very truly yours,
Fidelity Assurance Association
By Hubert F. Young

## CERTIFICATE OF AUDITOR AND EX OFFICIO INSURANCE COMMISSIONER AND SECRETARY OF STATE OF WEST VIRGINIA AS TO AMENDMENT OF CHARTER, CHANGE OF NAME AND LICENSING AS INSURANCE COMPANY

**(Exhibit 24)**

June 25, 1941

This is to certify that Fidelity Investment Association, with its principal place of business in Wheeling, West Virginia, chartered under the laws of the State of West Virginia to engage in the sale of annuity contracts on fixed and stipulated installments, made application to this office on December 31, 1940, as required under the provisions of section 3, article 2, chapter 33 of the 1931 Code of West Virginia, to change the charter powers of such corporation to include the power to engage in the life insurance busi-

ness and to change the name of the corporation from Fidelity Investment Association to Fidelity Assurance Association. These changes were approved by the Insurance Commissioner and The Honorable William S. O'Brien, Secretary of State, issued his certificate and changed the records of his office pertaining to this corporation as per the attached copy of the certificate of amendment.

Thereupon, the same date the corporation made application, copy of which is attached hereto, to the Insurance Commissioner of the State of West Virginia for a license to engage in the life insurance business as provided in article 3 of chapter 33 of the 1931 Code of West Virginia, as amended, and such license was granted, copy of which said license is also attached hereto.

On January 13, 1941, the company also made application, upon forms supplied by the Insurance Commissioner for that purpose, for the licensing of twenty-one persons to engage in the sale of life insurance policies, which said licenses were issued.

Furthermore, on January 14, 1941, the company filed, in duplicate, and secured approval for use in this state of a form titled, "Special Annuity Contract."

Also, on January 27, 1941, the company filed, in duplicate, and secured approval for use in this state of the following forms:

Ordinary Life
Ten Payment Life
Fifteen Payment Life
Twenty Payment Life
Fifteen Year Endowment
Twenty Year Endowment
Ten, Fifteen and Twenty Year Term

The company license, heretofore referred to as having been issued December 31, 1940, expired on March 31, 1941, as specified by law, and a renewal of such license was issued, dated April 1, 1941, for a term of one year, expiring March 31, 1942.

The foregoing statement is predicated upon the files and records of the office of the Insurance Commissioner in the State of West Virginia.

Given under my hand and official seal of office this 25th day of June, 1941.

Edgar B. Sims (Signed)

EDGAR B. SIMS

STATE AUDITOR & EX OFFICIO
INSURANCE COMMISSIONER

(SEAL)

STATE OF WEST VIRGINIA

(SEAL)

CERTIFICATE

I, WM. S. O'BRIEN, Secretary of State of the State of West Virginia, hereby certify that F. S. Risley, President of

FIDELITY INVESTMENT ASSOCIATION,

a corporation created and organized under the laws of the State of West Virginia, has certified to me under his signature and the corporate seal of said corporation, that, at a special meeting of the stockholders of said corporation, regularly held in accordance with the requirements of the

law of said State, at the Home Office of said corporation, in the City of Wheeling, State of West Virginia, on the 9th day of December, 1940, at which meeting a majority of the issued and outstanding voting stock of such corporation being represented by the holders thereof, in person, by bodies corporate or by proxy, and voting for the following resolutions, the same were duly and regularly adopted and passed, to-wit:

"BE IT RESOLVED,

'1. That Article 1 of the Certificate of Incorporation of the Association be amended by striking out of the name of the corporation the word 'Investment' and inserting in lieu thereof the word 'Assurance,' so that the name of the corporation after changed, shall be "Fidelity Assurance Association.'

"2. That Article 3 of the Charter, containing the purposes of the Association, be stricken out and that there be inserted in lieu thereof, as Article 3, the following purposes:

'To issue insurance upon the lives of persons and every insurance appertaining thereto and connected therewith, and to grant, purchase and dispose of annuities."

WHEREFORE, I do declare said amendment of the Certificate of Incorporation and change of name to be authorized by law, and that said corporation shall hereafter be known by the name of FIDELITY ASSURANCE ASSOCIATION.

(Signature and certification as to copy omitted.)

# REPORT OF CENTRAL TRUST COMPANY, TRUSTEE, ON SECURITIES COMPRISING THE INVESTMENT PORTFOLIO OF FIDELITY ASSURANCE ASSOCIATION, FILED MAY 15, 1942

(Omitting Schedules)

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In the Matter of
FIDELITY ASSURANCE ASSOCIATION,
Debtor
In Proceedings for Corporate Reorganization.
No. 4514.

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TO THE HONORABLE BEN MOORE,
JUDGE OF SAID COURT:

Central Trust Company, Trustee, respectfully reports unto Your Honor that since its appointment herein on June 6th, 1941, to the date hereof, it has been continuously studying and analyzing the various securities which comprise the Portfolio. The policy adopted by your Trustee as a yardstick for measuring the advisability of handling each individual issue has been, and continues to be, in effect, that preservation of principal is the primary object and that conservation of income, although important, is secondary to the preservation of principal.

Your Trustee further respectfully reports that all of the securities, excepting United States Treasury obligations and those rated "A" or better, are regarded in the main by your Trustee as either falling in the so-called "marginal"

classification, or securities which cannot be regarded as satisfactory for investment of savings funds.

Economic conditions, as a result of the present state of emergency occasioned by a transition from what may be termed a "peace economy" to a "war economy," have, in the opinion of your Trustee, increased the risks of such a heavy concentration in marginal securities, by reason of which your Trustee has suggested to the various State Depositories the advisability of considering the sale of many securities as hereinafter more particularly set out, and your Trustee is of the opinion that a great many more such suggestions will be made in the very near future, depending upon conditions affecting individual issues which may arise from day to day.

Your Trustee further respectfully reports that the factors which it interprets as indicating the market trend of the various groups of securities classified by your Trustee as marginal, may be more specifically expressed as follows:

STATE, COUNTY, MUNICIPAL and REVENUE BONDS. In the opinion of your Trustee, there are two important influences bearing on the future of individual state and municipal securities:

(1) The uncertainty as to the permanency of tax exemptions which exerts an influence on the market value of all states and municipals; and

(2) The decrease in revenues that may result in certain states and municipalities by reason of the dislocation of industries brought about by the war.

As to the first point, the Treasury proposal before Congress involving a recommendation for the retroactive elimination of tax exemption on state and municipal securities,

although Congress has given no indication that it will comply with the Treasury proposal, there is every indication that the Treasury will continue to press for the elimination of such tax exemption on state and municipal securities at subsequent opportunities and the threat will continue to overhang the entire state and municipal bond market. Of equal importance, states and municipalities that are dependent for revenues on gasoline taxes, sales taxes, tourist trade and the like may suffer severely. To summarize, your Trustee concludes that states and municipals today are being subjected to major changes bearing on the strength of their credit position, and this applies directly to many of the state and municipal securities now held in the Portfolio of the Debtor.

Your Trustee further respectfully desires to point out that in many cases exceptionally poor markets exist for the sale of the type of state and municipal issues held in the Portfolio. Therefore, considerable time is required in disposing of these securities to the best interests of the estate. The longer the delay in acting on such vulnerable securities, just to such an extent is the danger increased that satisfactory sale can be accomplished. Reasonable selling opportunities for the middle and lower grade securities would, in the opinion of your Trustee, develop only during periods of firm to uptrending prices, and at present such a period seems to have developed from the low levels of last January and February when war and the tax threats were being widely publicized and discussed; and it is only a matter of time until these factors calling for caution again get attention.

The revenue bonds are, in the opinion of your Trustee, even more vulnerable to the factors hereinbefore mentioned for state and municipal securities, for the reason that they are not general obligations and could be classified as taxable without violating states rights.

RAILROAD BONDS. As will hereinafter appear in more detail, your Trustee has recently suggested the advisability of considering the sale of many of the marginal railroad securities held in the Portfolio and deposited with various State officials. This is because of two main factors:

(1) The price appreciation which such bonds have attained; and

(2) The uncertainty as to how long such values can be sustained under war conditions.

Such bonds have now recovered to a price level where they are again selling in the area at which liquidation by banks and other financial institutions can reasonably be expected to be greatly accelerated.

Your Trustee is of the opinion that even with a background of favorable current railroad earnings (before taxes), there can be no assurance that further substantial recoveries in such securities will come about, and, furthermore, favorable markets for such securities are only available on a firm or rising trend.

There are many potential influences which might readily cause a considerable decline in the value of these securities. First, there is the uncertainty as to the duration of the war. An earlier than generally anticipated termination of the war would, in the opinion of your Trustee, cause a great increase in the liquidation of railroad securities by investors and institutions alike. The railroad industry al-

most more than any other single classification has obtained the greatest financial benefit from the war economy. Conversely, in the post war period, it must face a serious readjustment of its traffic and earning factors. The long term outlook, particularly the threat of truck and air freight competition, further emphasizes the advisability of protecting this trust against the consequences of overstaying the present position in railroad securities.

An added factor indicating the desirability of prompt action relative to the reduction of railroad bonds is the possibility that agitation for government operation of the railroads may develop in the event there is serious congestion growing out of the increased demands on the industry because of the movement of war materials. Assuming that any such possible government operation would be on a basis of a guaranty of earnings based on a three-year average of earnings, as was the case in the last war, there would be a sharp reduction in the net earnings available to the industry as compared with the prospects for 1942 under private operation. Of particular significance is the restraint which would thus be placed on the volume of bond repurchases in the open market by the railroad companies of their own securities, thus limiting purchases from the sources generally regarded as likely to provide the major support for such bonds.

A further factor of considerable weight is the very substantial blocks of these marginal railroad bonds held in the Portfolio. Considerable time must be allowed to effect an orderly sale of such large blocks, and, therefore, in the opinion of your Trustee, it is essential that such selling action be initiated during the period of demand for this

type of security in order to assure that such sales be accomplished at satisfactory levels.

PUBLIC UTILITY BONDS. Your Trustee respectfully submits that the best opportunities for disposing of marginal utilities may already have been passed, by reason of the fact that there has been a steady decline in the market value of this portion of the Portfolio for the past several months. The major influences exerting force on the market value of these securities is the inability of the utility industry to overcome the penalty of a rising tax structure and cost of operation without a comparative increase in rates. An estimated analysis based upon the pending tax bill now before Congress indicates a 15% to 20% decline in the net earnings of the public utility industry, the variation depending on the final tax terms which may be enacted.

Of even greater importance, in the opinion of your Trustee, is the fact that a conservative estimate of future tax factors leads to the conclusion that a high normal and surtax rate structure will endure well beyond the termination of the war. Thus the current decline in the utility industry earnings must be regarded as more or less of a permanent condition, with prospects for rehabilitation of earning power in the post war period likely to be held to negligible proportions.

As previously suggested, the opportunity for the most favorable disposal of this portion of the Portfolio already may have been passed. However, the dangers of further capital loss in these public utility securities are still of sufficiently large proportions to justify aggressive action in the sale of these securities, and your Trustee further desires to emphasize the necessity of prompt action because of the

very substantial blocks involved, which require emphasis upon orderly disposition to avoid unduly depressing the market. Once the tax bill is finally enacted by Congress, and the general public begins to find the reflection of such tax penalties in published earnings, the opportunities for disposal of such issues may be still further reduced, as against the present.

INDUSTRIAL BONDS. Your Trustee respectfully suggests that there are many of the same factors operating in the case of the industrial bonds in the Portfolio as are exerting an influence in other marginal securities. A substantial portion of the industrial bonds held represents companies that rank as war beneficiaries, and as such have enjoyed a substantial temporary recovery in earning power. In numerous cases sinking fund provisions, based on a rate of earnings, have been the important contributing factor in the market conditions for such issues. It is significant that this temporary stimulus of war earnings has influenced the market conditions for many of the Portfolio industrial issues, with the result that they have only recently been selling in the open market for close to the top price in the war period, and in many instances 20 or 30 points above the levels which they might be expected to command in a peace economy. Your Trustee, therefore, respectfully suggests that such opportunities as have been presented should be realized upon in order that the preservation of the principal may thus be obtained at the satisfactory levels now prevailing.

REAL ESTATE BONDS. Your Trustee further respectfully submits that the real estate issues held in the Portfolio are, in the main, highly speculative, and in many cases

involving defaults, and are, therefore, in much the same position as other marginal securities. Some of the issues are deriving partial benefit from the war economy, and such an improvement is being reflected in the price of the individual issues. These factors, among others, would seem to dictate the desirability of prompt action, and your Trustee feels that certain of these issues should be disposed of as opportunities are presented. Here again the matter of orderly liquidation would be a paramount problem since marketability of this type of issue is exceptionally poor, thus if a decision is made to dispose of any individual issue, your Trustee will require a considerable period of time, in all probability, before a market can be found. This, of course, further substantiates the fact that prompt, rather than delayed, action is desirable.

MISCELLANEOUS BOND GROUP. The thirteen bond issues contained in the financial and foreign group represent special situations, each of which must be decided on its own merits. Action on these issues is largely a matter of price, with a view of taking advantage of such market opportunities as may develop.

PREFERRED AND COMMON STOCKS. This portion of the Portfolio represents a highly volatile group of issues, which is subject to all the uncertainties of the stock market. As such, they should be regarded as candidates for ultimate disposal. Individual decisions will depend on timing of market factors, and the individual influences, such as taxes, which affect the value of each specific security. As the spring war campaigns unfold, the price of these individual issues may readily be subjected to considerable pressure, although as a group they may be expected in turn to

respond to a possible improvement in war news to a greater extent than the bond portion of the Portfolio. Your Trustee suggests particular attention to the industrial issues which constitute the heaviest portion of the stock Portfolio. This group is constituted in substantial part in war beneficiaries, such as the steel, paper and machinery industries. In the opinion of your Trustee, it is essential that these issues be disposed of well before the termination of the war economy if a reasonable price is to be obtained.

Your Trustee further respectfully submits that the above comments have been confined to an expression of general policy rather than a discussion of individual issues. Recommendations as to individual issues are more particularly set out on a comparative summary of the Portfolio of Fidelity Assurance Association prepared by Standard & Poor's Corporation hereto attached, marked "EXHIBIT A" and prayed to be made a part hereof. This comparative summary gives the par value, book value and market value of each individual issue as of June 6, 1941, December 31, 1941, and March 31, 1942, in addition to which is a recommendation as to the disposition of each issue as of March 31, 1942.

Your Trustee further respectfully submits a schedule showing the securities recommended for sale on deposit with various States which said schedule is hereto attached, identified as "EXHIBIT B" and prayed to be made a part hereof, which said schedule shows, by States, sale recommendations complied with, sale recommendations not complied with, and as to each individual issue the book value June 6, 1941, the value as of date sale was recommended the unit price, value at date of recommendation, unit price

at date recommendation withdrawn, proceeds of sale, unit price market March 31, 1942.

Your Trustee respectfully directs Your Honor's attention to the fact that the only States which have complied with the recommendations of your Trustee are Delaware and Missouri. Illinois and Maryland each made one sale as suggested by your Trustee, and your Trustee respectfully directs Your Honor's attention to the fact that in making the sale handled by the State representative, a price from 2 to 3 points under the market at the date of recommendation was obtained by the State officials, respectively. Your Trustee does not intend to criticize the State officials, but merely desires to call attention to the fact as substantiating the position of your Trustee, to the effect that skilful handling of sales is necessary to avoid depressing the market.

Your Trustee further respectfully reports unto Your Honor that as of May 1st, 1942, it suggested to various State Depositories the advisability of selling a very substantial number of securities, all as more particularly shown by a detailed list thereof hereto attached and marked for identification purposes "EXHIBIT C" and prayed to be made a part hereof. The State of Missouri is the only depository which has complied.

As shown by the schedule hereto attached, marked "EXHIBIT D" and made a part hereof, your Trustee has, as therein set out, made purchase recommendations, and only the Delaware and Missouri depositories have complied as indicated. A very substantial loss of income is resulting thereby because of the fact that there is now available cash on deposit with the various State officials in excess of three million dollars ($3,000,000.00) as shown by a statement

thereof, by States, hereto attached and marked "EXHIBIT E," and made a part hereof.

In conclusion, your Trustee respectfully submits that in its opinion it would be for the best interests of the estate to have all the securities comprising the Portfolio of the Debtor, regardless of location, either placed in the actual custody of your Trustee or placed in the custody of the State Depositories' New York correspondent banks subject to the orders of your Trustee for the purpose of facilitating delivery against payment, and therefore recommends that a decree be made and entered herein to the foregoing effect.

No. 319

Office - Supreme Court, U. S.
FEB 2 1943

IN THE

# Supreme Court of the United States

OCTOBER TERM, 1942.

FIDELITY ASSURANCE ASSOCIATION, A CORPORATION, DEBTOR, AND CENTRAL TRUST COMPANY, TRUSTEE FOR FIDELITY ASSURANCE ASSOCIATION,

*Petitioners.*

VS.

EDGAR B. SIMS, AUDITOR OF THE STATE OF WEST VIRGINIA, AND EX OFFICIO INSURANCE COMMISSIONER OF THE STATE OF WEST VIRGINIA; ROSS B. THOMAS AND H. ISAIAH SMITH, WEST VIRGINIA STATE COURT RECEIVERS; BANKING COMMISSION OF WISCONSIN; CHARLES R. FISCHER, COMMISSIONER OF INSURANCE AND PERMANENT RECEIVER FOR DEBTOR CORPORATION IN AND FOR THE STATE OF IOWA; JOHN B. GONTRUM, INSURANCE COMMISSIONER OF THE STATE OF MARYLAND; DEWEY S. GODFREY, MISSOURI STATE COURT RECEIVER; L. H. BROOKS, TRUSTEE, FREDERIC LEAKE AND A. L. GOLDBERG, JR., TRUSTEE; AND SECURITIES AND EXCHANGE COMMISSION,

*Respondents.*

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT.

## BRIEF OF RESPONDENT, JOHN B GONTRUM, INSURANCE COMMISSIONER OF THE STATE OF MARYLAND.

GUY B. BROWN,
H. VERNON ENEY,
Counsel for the Respondent,
John B. Gontrum, Insurance Commissioner of the State of Maryland.

The Daily Record Co. Print, Baltimore.

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IN THE

# Supreme Court of the United States

OCTOBER TERM, 1942.

No. 319

FIDELITY ASSURANCE ASSOCIATION, A CORPORATION, DEBTOR, AND CENTRAL TRUST COMPANY, TRUSTEE FOR FIDELITY ASSURANCE ASSOCIATION,

*Petitioners,*

VS.

EDGAR B. SIMS, AUDITOR OF THE STATE OF WEST VIRGINIA, AND EX OFFICIO INSURANCE COMMISSIONER OF THE STATE OF WEST VIRGINIA; ROSS B. THOMAS AND H. ISAIAH SMITH, WEST VIRGINIA STATE COURT RECEIVERS; BANKING COMMISSION OF WISCONSIN; CHARLES R. FISCHER, COMMISSIONER OF INSURANCE AND PERMANENT RECEIVER FOR DEBTOR CORPORATION IN AND FOR THE STATE OF IOWA; JOHN B. GONTRUM, INSURANCE COMMISSIONER OF THE STATE OF MARYLAND; DEWEY S. GODFREY, MISSOURI STATE COURT RECEIVER; L. H. BROOKS, TRUSTEE; FREDERIC LEAKE AND A. L. GOLDBERG, JR., TRUSTEE; AND SECURITIES AND EXCHANGE COMMISSION,

*Respondents.*

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT.

## BRIEF OF RESPONDENT, JOHN B GONTRUM, INSURANCE COMMISSIONER OF THE STATE OF MARYLAND.

### OPINIONS BELOW.

The opinion of the District Court is printed in the record (R. 176-202) and is reported in 42 Fed. Supp. 973.

The opinion of the Circuit Court of Appeals for the Fourth Circuit is printed in the record (R. 238-263) and is reported in 129 Fed. (2d) 442.

The opinion of the District Court and the final order of the District Court approving the Debtor's petition were filed on January 5, 1942 (R. 175-176). The decree of the Circuit Court of Appeals reversing the District Court was entered on June 16, 1942 (R. 263-264). A petition for rehearing was filed on July 13, 1942 (R. 264-266), and was denied on July 22, 1942 (R. 267). The petition for certiorari was filed on August 20, 1942, and granted on October 12, 1942 (R. 286).

## JURISDICTION.

The jurisdiction of this Court is invoked under Sec. 240(a) of the Judicial Code, as amended (U. S. C. Tit. 28, Sec. 347(a)), and Sec. 24(c) of the Bankruptcy Act (U. S. C. Tit. 11, Sec. 47(c)).

## STATUTES INVOLVED.

The statutes involved are Chapter X of the Federal Bankruptcy Act (U. S. C. Tit. 11, Secs. 501-676) relating to the reorganization of certain private corporations; the Federal Investment Company Act of 1940 (U. S. C. Tit. 11, Sec. 107(f), and Tit. 15, Secs. 80a-1 to 80a-52), relating to the federal regulation of so-called face amount certificate companies; Secs. 218 to 234 of Art. 48A of the Annotated Code of Maryland (1939 Ed.), Tit. "Insurance", Sub-Tit. "Installment Accumulation Contracts", relating to the regulation by the State of Maryland of the sale of so-called "face amount certificates" or "installment accumulation contracts"; and similar regulatory statutes of the States of Alabama, Delaware, Illinois, Iowa, Indiana, Kansas, Kentucky, Missouri, Ohio, Pennsylvania, Tennessee, Virginia, West Virginia and

Wisconsin. The particular sections of Chapter X of the Federal Bankruptcy Act and of the Federal Investment Company Act which will be relied upon in this brief will be printed in the argument. The pertinent Maryland statutes are printed as Appendix A to this brief. The other state statutes relating to the regulation of Fidelity Assurance Association are printed in Appendix D to the brief of the Securities and Exchange Commission.

## STATEMENT OF THE CASE.

Fidelity Assurance Association, formerly Fidelity Investment Association, a corporation of the State of West Virginia with its principal office at Wheeling, West Virginia, for a number of years had been engaged in the business of selling a form of annuity contract somewhat similar to that issued by insurance companies. The company did business in 29 states, most of which had laws regulating the conduct of such business. In 15 states, including its home state of West Virginia, Fidelity was required to deposit securities with designated state officials to secure the payment of its liabilities on contracts issued in such states. As of the time of the institution of this proceeding, the value of these deposited securities was in excess of $20,000,000, about one-half of which amount was deposited with the State of West Virginia.

On December 31, 1940, Fidelity ceased issuing any contracts because it could not comply with the provisions of the Federal Investment Company Act of 1940 which took effect on January 1, 1941. On April 11, 1941, receivers were appointed for Fidelity by the Circuit Court of Kanawha County, West Virginia. The receivers took charge of the free assets of Fidelity, which amounted to something less than $1,000,000.00, and continued in charge until June 6, 1941, when Fidelity filed in the Dis-

trict Court of the United States for the Southern District of West Virginia a voluntary petition for reorganization under Chapter X of the Bankruptcy Act. On the same day, by *ex parte* order, the District Court undertook to require the immediate surrender to a trustee appointed by it, of the approximately $20,000,000 of securities which had been deposited by Fidelity with state officials. On June 10, 1941, again by *ex parte* order, the order of June 6, 1941, was amplified so as to be specifically directed against the state officials, who were designated by name and title.

None of the deposited securities were surrendered to the Trustee by any of the state officials. Some of the states filed answers controverting the allegations of the Debtor's petition and others filed motions to strike out and rescind the turnover orders of June 6 and June 10, 1941. Some states filed both answers and motions to strike out the turnover orders, and controversial answers and similar motions were also filed by creditors. The Insurance Commissioner of Maryland, who held a little less than $500,000 of securities which had been deposited with him by Fidelity as required by the laws of the State of Maryland, filed a motion to strike out the turnover orders, but did not file an answer controverting the allegations of the Debtor's petition.

The State of West Virginia and the West Virginia state court receivers had filed motions to strike out the turnover orders of June 6 and June 10, 1941, a few days after the entry of said orders, and after a brief hearing these motions were overruled, whereupon an appeal was entered to the Circuit Court of Appeals for the Fourth Circuit. While these appeals were pending the District Court heard argument on the similar motions of the State of Maryland and other states but it did not act immed-

iately on the motions. Instead, on motion of the trustee appointed by it, the District Court on August 9, 1941, amended its turnover orders of June 6 and June 10, 1941, by eliminating the provisions thereof requiring the various state officials to turn over the deposited assets to the Trustee for the Debtor, and in lieu thereof, enjoined the state officials from making any disposition of the deposited securities. The long (and needlessly involved) order of August 9, 1941, is printed in the record (R. 102-114). This action rendered moot the questions pending on appeal but the State of Maryland and other states promptly filed motions to strike out the injunction order of August 9, 1941. Argument was heard on said motions but the District Court did not act thereon until the conclusion of the hearing on the petition and controversial answers.

After an extended hearing over a period of several months, the District Court filed a lengthy opinion (R. 176-202) in which numerous objections to the jurisdiction of the court interposed by the respondents were considered and overruled. On January 5, 1942, the District Court entered an order (R. 175-176) approving the debtor's petition for reorganization and specifically overruling the motions to strike out the turnover orders of June 6 and June 10, 1941, and the injunction order of August 9, 1941. An appeal to the Circuit Court of Appeals for the Fourth Circuit was filed on March 12, 1942, and that Court, holding that the Debtor was an insurance company and also that the petition had not been filed in good faith, reversed the District Court and remanded the cause with directions to the District Court to dismiss the petition (R. 263-264).

While the Circuit Court of Appeals did not deem it necessary to pass directly upon the question of whether

the District Court had authority to enter the turnover orders of June 6 and June 10, 1941, or the injunction order of August 9, 1941, in view of its decision on the other points which were decisive of the case, nevertheless the question is presented to this Court inasmuch as the order of the District Court entered on January 5, 1942, from which the appeal was taken, not only approved the filing of the Debtor's petition but also specifically overruled the motions to strike out the turnover orders and the injunction order. Accordingly, the question of whether the District Court had authority to enter such orders will be argued in this brief.[1]

## THE FACTS.

Inasmuch as a complete and comprehensive statement of the facts relating to Fidelity Assurance Association and this reorganization proceeding is contained in the Wisconsin-Iowa brief, it will not be necessary to make an extended statement of the facts in this brief. However, we do wish to point out and emphasize the facts relating particularly to the situation of this respondent and certain other vital facts and circumstances which we will especially rely upon in the argument in this brief.

### *Maryland Statute and Proceedings.*

In Appendix D to its brief, the Securities and Exchange Commission purports to print the pertinent Maryland statutes (S. E. C. Appendices, 41-44). However, the Securities and Exchange Commission has omitted

[1] Even though the Respondents have not sought a review of the decision of the Circuit Court of Appeals, nevertheless they are not limited in the argument before this court to points decided by the Circuit Court of Appeals. The entire record is before this court, and the Respondents may urge any legal grounds which will support the judgment of the Circuit Court of Appeals. *Lagnes v. Green*, 282 U. S. 531; *Story Parchment Co. v. Paterson Parchment Paper Co.*, 282 U. S. 555; *Helvering v. Gowran*, 302 U. S. 238; *Le Tulle v. Scofield*, 308 U. S. 415; *Ryerson v. United States*, 312 U. S. 405.

to print all of the pertinent parts of the Maryland statute and we have, therefore, printed the same as Appendix A to our brief. In addition, because of its complete misunderstanding of the nature of the Maryland proceeding, the Securities and Exchange Commission has printed certain Maryland statutes (Sections 52 and 61 of Article 48A of the Maryland Code) which are applicable to the liquidation of insolvent or illegally conducted companies similar to Fidelity but which have no application whatsoever to the pending Maryland proceeding.

In April, 1941, Fidelity Assurance Association had no assets physically located in the State of Maryland which could have been taken possession of by a receiver. The only assets in the State of Maryland were the securities which had been assigned to and deposited with the Insurance Commissioner of Maryland and which were held in trust by him under the provisions of the Maryland statute. Consequently, when proceedings were instituted against Fidelity in West Virginia on April 11, 1941, the Insurance Commissioner of Maryland made no effort to institute receivership proceedings under Section 52 of Article 48A of the Maryland Code because there were no assets to be turned over to a receiver. The Maryland Insurance Commissioner, as Trustee, continued to hold the deposited securities and later the Circuit Court of Baltimore City, an equity court, in the exercise of its ordinary chancery powers assumed jurisdiction of, and supervision over the administration of the trust.

It will thus be seen that not only is there no receivership proceeding pending in Maryland but likewise there is no reorganization or rehabilitation proceeding, or any other kind of proceeding directed against the Fidelity Assurance Association. The only pending proceeding

is an ordinary chancery proceeding for the administration of a trust under the jurisdiction of the court. Under Maryland law the Trustee (the Insurance Commissioner of Maryland), in the management and final liquidation of the trust, is subject to the complete control of the Circuit Court of Baltimore City.

More than a year and a half has elapsed since the institution of this proceeding in the District Court. During that time some of the securities held by this respondent as trustee have been called for redemption and other securities have, at the request of the Trustee for the Debtor and pursuant to the order of the Circuit Court of Baltimore City, been sold. In this way approximately 36% of the trust assets held by this respondent have been liquidated and are now represented by cash.

***Fidelity's Relations With the State of Maryland:***

Pursuant to the provisions of Section 222 of the Maryland statute, Fidelity in 1932 assigned to and deposited with the Insurance Commissioner of Maryland certain securities having an approximate market value of $500,000. From time to time additional securities were assigned to and deposited with the Insurance Commissioner of Maryland by Fidelity and securities then held by him were thereupon surrendered to Fidelity. As of June 6, 1941, the securities in the possession of the Insurance Commissioner of Maryland had a market value of $470,806.25 and as of April 10, 1941, the net cash liability of Fidelity on its contracts held by persons then residing in Maryland was $492,552.24 and the reserve liability on these same contracts was $508,163.70 (Exhibit No. 48, R. 814). There is testimony in the record to the effect that there are 2080 such contracts held by persons now resident in the State of Maryland but the formal report and list of contract holders filed

with the District Court by the Trustee for Fidelity discloses only 1135 such contracts, with approximately the same reserve and cash surrender liabilities. The difference of 915 contracts represents those contracts which are delinquent and on which there is no present liability by Fidelity, but under the terms of which the contract holders have certain options, such as redating privileges, privilege to pay up arrearages and reinstate the contract, etc.

The petitioners and the Securities and Exchange Commission contend that on its books Fidelity kept accurate and separate accounts for the reserve funds of each series of contracts issued by it and that the books indicated what securities were purchased with the reserve funds of each series. These statements are misleading. It is true that the testimony developed that Fidelity maintained books showing such a segregation of reserve funds by series but none of the securities themselves were in any way earmarked and it does not appear that even on the books, particular securities could be identified as belonging to any one series where securities of the same issue may have been purchased from the reserve funds of two or more series.

In other words, the securities themselves were not identifiable with any particular reserve fund, and prior to the institution of an injunction proceeding by the Securities and Exchange Commission in the latter part of 1938 Fidelity had made no effort to segregate the securities deposited with each state in accordance with the outstanding contracts of each series in such state. It was only during the past few years and after the entry of the injunction order in December, 1938, that Fidelity made any attempt to segregate its state deposits by series (R. 634-635), and by that time the deficiency

in assets made segregation impossible (R. 608, 638). There is some testimony of efforts on the part of Fidelity in 1939 and 1940 to advise some state officials of a segregation by series of the securities deposited with such state officials (R. 754-756) but the record does not disclose that any effort was ever made to advise the Insurance Commissioner of Maryland of the segregation on the books of Fidelity (R. 754, 756), and the only direct evidence on this point is that the Insurance Commissioner of Maryland was not advised of the breakdown into series funds of either the deposited securities or of Fidelity's liabilities in the State of Maryland. See note at the bottom of the first page of Exhibit No. 79.

It should also be pointed out that even where Fidelity made some effort to advise state officials of the segregation of the securities by series funds, such advice was not given at the time of the deposit of the particular securities (R. 646-648, Exhibit 67) but the state officials were advised some months later and after they had accepted the securities as a general deposit without segregation by series. In addition there was not only no effort to advise contract holders that state deposits were to be segregated by series, but on the contrary each contract holder was given a booklet which called his attention to the fact that "the securities deposited with state authorities are subject to the requirements of the states with respect to all the contract funds of Fidelity Investment Association, and are not necessarily held for the sole benefit of the holders of these particular contracts." (R. 657, 765).

The securities deposited in Maryland are registered in the name of the Insurance Commissioner of Maryland as Trustee and under the provisions of the Maryland statute these securities were and are held by him "in trust,

as security for all the holders of contracts or other obligations * * * sold, negotiated, issued or accrued in said company in the State of Maryland". In no instance were the securities which were deposited in Maryland earmarked as belonging to any particular series. For instance, no securities were ever registered in the name of "Fidelity Investment Company in trust for Series B contract holders". On the other hand, in many instances the securities deposited with the Insurance Commissioner of Maryland were purchased by Fidelity specifically for the purpose of making such deposit and were caused by Fidelity to be registered initially in the name of the Insurance Commissioner of Maryland. Consequently the Insurance Commissioner of Maryland at the time the securities were deposited had no notice whether they had been purchased from general funds of Fidelity or from reserve funds allocated to one or the other of the various series of contracts issued by Fidelity.

***Insolvency of Fidelity.***

The Debtor in its brief makes the bland assertion that Fidelity is 90% solvent. The District Court fell into the same error. It is true that on the basis of schedules submitted by the Debtor, the assets of Fidelity (95% of which are deposited assets) amount to about 90% of the aggregate cash surrender value of Fidelity's outstanding contracts. These figures are, however, misleading both as to the value of the assets and as to the extent of the liabilities.

In preparing such schedules some effort was made to show the market value rather than the book value of securities which had a market value, but with respect to securities which had no readily ascertainable market value and with respect to the tangible assets of Fidelity,

book values were used in arriving at the total value of assets. No effort was made to appraise these assets and no testimony was offered as to their real value. The indications are that these assets, such as, for instance, the Home Office building at Wheeling carried on the books at $450,000.00, are worth very much less than their book value. Accordingly, while the record does not show the true value of all the assets, we may safely assume that it is less than the figure submitted by the Debtor and relied on by the District Court and by the Securities and Exchange Commission.

On the other hand, the liabilities are understated. In the first place, there is not the slightest warrant for using the cash surrender value of contracts as the measure of the liability of Fidelity to its contract holders. At the very least the contract liability of Fidelity is the reserve value of each contract.[2] The reserve liabilities exceed the cash surrender liabilities by $745,982.69 (see Exhibit 48, Tr. 1116). As a matter of fact the liability to the contract holders may actually be considerably in excess of this amount because the contract has been broken not by the contract holder but by Fidelity, and in measuring the damages for the breach of contract, a contract holder might not necessarily be limited to the reserve liability on the contract. In addition, these schedules do not indicate the extent of Fidelity's liabilities to persons other than contract holders, and we have no way of knowing what such claims may

[2] This was recognized by the Securities and Exchange Commission in its brief filed as amicus curiae in the 1938 receivership proceeding involving Fidelity. *Hutchinson v. Fidelity Investment Co.*, 106 Fed. (2d) 431. At pages 34 and 35 of its brief as amicus curiae, the Securities and Exchange Commission objected strenuously to the use of the cash surrender values to measure liabilities and insisted that "the company's real liability is the actuarial reserve necessary to pay the contracts at maturity according to their terms", and that "the present existence of a liability equal to the entire actuarial reserve is indisputable".

amount to. The testimony does indicate that the Federal Government alone is asserting an income tax deficiency amounting to approximately a quarter of a million dollars (R. 1221, Exhibit 118).[3] Accordingly while the exact amount of the liabilities does not appear, it is clear that they are substantially in excess of the amount shown on the schedules submitted by the Debtor.

The record, therefore, does not support the statement that Fidelity as a whole is 90% solvent. On the contrary, the indications are that it is much less than 90% solvent although the Debtor has failed to show exactly what deficiency of assets there is.

The petitioners fall into the same error in making the statement (brief p. 46) that reserve funds A, B, C and D are solvent. As pointed out in the Securities and Exchange Commission brief (pp. 7, 8), securities were "sold" and moneys were "borrowed" on open account between the separate series funds. The Securities and Exchange Commission admits that the series funds which have inter-fund accounts payable are insolvent, and that "the solvency of other funds depends on the extent to which their inter-fund accounts receivable are collectible assets".

Even if on the books of Fidelity it should appear that one or more series funds were solvent, this would only be on the basis that all of the securities which had been purchased from the reserve fund of that series could be recovered and applied solely to the payment of the liabilities on that series of contracts. As we shall show later in this brief, such an assumption is clearly untenable.

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[3] An examination of the notice of the deficiency assessment, Exhibit 118, shows that the Commissioner of Internal Revenue has completely disregarded the series trust fund theory, and is assessing income taxes on the basis of the total income from all the securities, irrespective of series.

*Contract Provisions as to Segregation of Reserve Funds.*

The statement is made by the petitioners that the contracts of all series provide for the creation and maintenance of a separate reserve fund solely for the discharge of the liability upon the contracts of that series. This statement is incorrect. No such provision is contained in the special income contract, the special annuity contract or, the Series A contract. There is only one Series C contract outstanding (R. 492). The contracts which contain such a provision are Series B and D. It is true that all of the contracts contain a provision that a certain portion of the payments of each contract holder shall be set aside in a reserve fund which reserve fund shall be invested in approved securities and deposited in trust as required by the laws of the State of West Virginia. There is no indication, however, except as to the Series B and D contracts, that such reserve funds are to be kept separate solely for the discharge of liabilities under contracts of that particular series.

## SUMMARY OF ARGUMENT.

### I.

The basic, fundamental issue in this case is whether the state deposit statutes are valid and effective, or whether such statutes may be abrogated to the extent that they prevent or interfere with any plan of reorganization which the Debtor may desire to effect under the provisions of Chapter X. If not, this proceeding is at an end because the free or undeposited assets of the Debtor are negligible, and unless the state deposits can be seized by the bankruptcy court there is no possibility of reorganizing the Debtor. We contend that the state deposits are not subject to the jurisdiction and control of the bankruptcy court.

A. The state deposit statutes are valid regulatory laws enacted pursuant to the police power reserved to the states by the Tenth Amendment. These statutes provide for the creation of an actual trust for the benefit of citizens of the respective states, and although they provide for liquidation of the trust assets in certain contingencies, they are not mere insolvency statutes which would be superseded by the bankruptcy statutes.

B. Title to, as well as possession of the state deposits are in the various state officials, as trustees, and the state deposits therefore do not constitute property of the Debtor subject to the jurisdiction of the bankruptcy court. Accordingly the bankruptcy court has no authority to require the surrender of the state deposits or to enjoin the disposition thereof by the state officials pursuant to the provisions of the various state laws.

C. The state officials having possession of the state deposits are immune from the judicial process of the federal courts under the provisions of the Eleventh Amendment. Although the states perhaps have no pecuniary interest in the deposited securities, nevertheless they have seen fit to throw their cloak of immunity around the state deposits, and the turnover orders and the injunction order directed against the state officials in their capacity as such are therefore void.

D. Even though it were assumed *arguendo* that the state officials were not immune from the process of the federal court under the Eleventh Amendment and that the bankruptcy court had a discretionary power temporarily to enjoin the disposition of the deposited securities, nevertheless the federal courts, having a scrupulous regard for the rightful independence of state governments, should be extremely loathe to issue turnover orders or

injunction orders against state officials in cases like the present. The issuance of such orders by the District Court in the case at bar constituted an abuse of discretion, rather than a wise exercise of discretion.

II.

The petition of the Debtor was not filed in good faith within the meaning of Section 146(3) of Chapter X in that it is unreasonable to expect that a plan of reorganization can be effected.

A. The Debtor has not met the burden of proving that it is not unreasonable to expect that a plan of reorganization can be effected. On the evidence it is clear, and all parties virtually concede, that there is no real possibility of a rehabilitation of the Debtor as a going concern.

B. A "slow and orderly liquidation" is not a plan of reorganization within the meaning of Chapter X, but even if a plan providing for the creation of some sort of liquidating corporation to conduct a slow and orderly liquidation of the Debtor's assets could be considered a plan of reorganization within the meaning of Chapter X, nevertheless there has been no showing by the Debtor that any such plan is necessary or would be beneficial to contract holders, or that it is reasonable to expect that any such plan could be effected.

III.

The petition was not filed in good faith within the meaning of Section 146(4) of Chapter X because it appears that the interests of the creditors would be best subserved in the prior pending state court proceedings.

A. Since there is no hope of a reorganization of Fidelity, as distinguished from a liquidation, the so-called

"safeguards" of a Chapter X proceeding are not pertinent considerations.

B. A central administration by the federal court is not essential in order that an impartial investigation of the acts of the management of the Debtor can be made. Nor is there any necessity for a single administration of the Debtor's affairs in the federal court in order to settle any supposed problems of marshalling assets and of distribution, or in order to properly liquidate the assets of Fidelity. Liquidation can be accomplished just as efficiently and much more expeditiously in the pending state court proceeding.

C. A central administration is not necessary in order to determine the numerous questions alleged to exist with respect to the construction of the state statutes and the determination under state laws of the relative rights of the contract holders. Such questions of state law can best be determined by the state courts, and the federal courts should be extremely reluctant to undertake to construe and apply the state statutes.

## ARGUMENT.

### I.

### THE STATE DEPOSITS ARE NOT SUBJECT TO THE JURISDICTION AND CONTROL OF THE BANKRUPTCY COURTS.

The basic, fundamental issue in this case is whether or not the statutes of the various states where Fidelity made deposits to secure contract holders are valid and effective, or whether such statutes are to be abrogated to the extent that they prevent or interfere with any plan of reorganization which a debtor may desire to effect under the provisions of Chapter X of the Bankruptcy Act. The question is fundamental because 95% of Fidelity's assets are deposited with the officials of fifteen

different states pursuant to the laws thereof and if these statutes are to be given effect, the deposited securities must be distributed in accordance with the laws of those states to the persons entitled thereto and it is futile to talk about reorganization of Fidelity either as a going concern, or by means of a "slow and orderly" liquidation through the federal court as a central administrative agency. Unless the federal court can ignore the state statutes and require the various state officials to surrender the securities in their possession to the Trustee for the Debtor this proceeding is at an end because the free, or undeposited assets of Fidelity are insignificant in comparison with its liabilities. Recognizing this fact, the Debtor, the Trustee and the Securities and Exchange Commission have from the very beginning sought to have the District Court secure the control and possession of the deposited securities. Without the deposited securities, there is nothing left to reorganize.

On the other hand, the states whose citizens are fairly well protected by adequate or nearly adequate deposits have resisted from the beginning all efforts to compel them to surrender the securities,[4] and it was for this reason that the State of Maryland and other states refused to comply with the turnover orders entered by the District Court on June 6 and June 10, 1941, and instead filed motions to strike out and rescind such orders, thereby immediately raising the fundamental issue of whether or not the state deposits were subject to the jurisdiction and control of the bankruptcy court. The Debtor, the Trustee, the Securities and Exchange Commission, and the District Court, while asserting the paramount authority of the bankruptcy court over the state

[4] Even the states where the deposits are wholly insufficient to secure the outstanding liabilities refused to surrender their deposits and none of them have at any time suggested that the well secured states give up their deposits.

deposits have constantly endeavored to avoid a decision on the fundamental question of the validity of the state deposit laws. The District Court overruled a motion of the West Virginia respondents to strike out the turnover orders, and while an appeal from that order was pending in the Circuit Court of Appeals for the Fourth Circuit, and while the motions of the State of Maryland and other states to strike out the orders of June 6 and June 10, 1941, were pending and undisposed of, the District Court entered its amendatory order of August 9, 1941, thereby rendering moot the question then pending on appeal, at least for the time being.

Not until after the District Court had completed the hearing and had finally approved the Debtor's petition did it formally overrule the motions of the State of Maryland and other states (R. 175). A number of times during the course of the hearing the District Court disavowed any intention to interfere with any vested rights of contract holders in state deposits but postponed consideration of what, if any, vested rights there were. The District Court took the position that the construction of such state statutes, that is the determination of the effect thereof and whether any contract holders were secured thereby, and if so what contract holders, and the extent to which they were secured, were questions which the District Court and not the state courts would decide. Similarly the District Court, even after the turnover orders were modified on August 9, 1941, continued to assert the right to require the surrender of the state deposits in the future (R. 958). Thus, while giving lip service to the principle that the state deposit laws are valid, the District Court strikes at the very heart of the state statutes by its holding that the state deposits are subject to the jurisdiction and control of the bankruptcy

court. In the same way both the Debtor and the Securities and Exchange Commission, while even now stating that they do not contend that the state deposit laws are invalid or that they should not be given full effect, nevertheless assume a position completely contrary to such statements.

It seems futile for the Debtor to urge and the District Court to decide that it is reasonable to expect that a plan of reorganization of Fidelity can be effected, reserving for later determination the question of whether there will be any property to form the basis for a reorganization. It seems to us that it would have been much better had the District Court first determined the fundamental question of its authority over the state deposits, and then determined the question of whether Fidelity could be reorganized only in the event it concluded that it did have authority over the state deposits and could subject them to its control. In this way the extended hearing as to the feasibility of reorganization might have been avoided. Such was the procedure approved by the Circuit Court of Appeals for the Fourth Circuit in *Seaboard Terminals Corp. v. Western Maryland Railway Co.*, 108 Fed. (2d) 911, where the District Court first determined the question of title to property claimed by the debtor before undertaking to determine the question of whether it was feasible to reorganize the debtor.

We contended in the District Court and in the Circuit Court of Appeals and we contend now, (1) that the state deposit laws are valid and effective regulatory statutes enacted pursuant to the reserved powers of the states under the Tenth Amendment to the Federal Constitution; (2) that the securities deposited with various state officials do not constitute "property of the debtor" within the meaning of Chapter X of the Bankruptcy

Act; (3) that the state officials having possession of such securities are immune from the judicial process of the federal courts under the Eleventh Amendment to the Constitution; and (4) that even if it be assumed *arguendo* that the bankruptcy court has some measure of jurisdiction or control over the state deposits, the *ex parte* turnover orders of June 6 and June 10, 1941, and the injunction order of August 9, 1941, were an abuse of discretion.

***1. The State Deposit Laws Are Valid And Must Be Given Full Effect By The Bankruptcy Courts.***

By the Tenth Amendment to the Federal Constitution there is reserved to the several states, or to the people thereof, all powers not delegated to the United States by the Constitution nor prohibited by it to the states. Within the limits of the powers thereby reserved to them, the states are as independent of the federal government as that government within its sphere is independent of the states.

One of the most important of the powers thus reserved to the states is the police power, and it was in the exercise of the police power that the State of Maryland and other states passed statutes regulating the sale of installment accumulation contracts, a business affected with a public interest. Corporations issuing and selling such contracts could only do so upon compliance with the laws of the respective states in which they sought to do business. The statutes of the 29 states in which the Debtor transacted business vary widely in their specific provisions and it is not possible within the limits of this brief to refer to and discuss the statutes of all 29 of these states. Accordingly we will confine our discussion to the statutes of Maryland, although the general argument set out in this portion of our brief is

applicable, with perhaps some modifications, to at least the 15 states in which the Debtor made deposits to secure its contract holders.

The statute passed by the State of Maryland provides in detail for the regulation of the business conducted by companies selling such contracts, and probably the most important regulatory provision is that requiring the assignment and deposit of *approved securities* to be held *in trust* by the state for the benefit of the persons designated in the statute. The Maryland statute is therefore a declaration of a public policy; a statute passed by a sovereign state in a valid exercise of its police power. The police power to pass such legislation is one undoubtedly reserved to the States by the Tenth Amendment to the Federal Constitution. It is a power which never has been, and never can be, delegated to the federal government as long as we are to have a dual system of government—as long as there is to be an indestructible union composed of indestructible states.

The Maryland statute is not at all a mere liquidation or insolvency statute, and as such susceptible of being interpreted as legislation upon the subject of bankruptcies and thus falling within the powers expressly granted to the federal government. It is true that the Maryland statute does provide a method by which deposits made by such companies shall be liquidated in the event they become insolvent, but the primary purpose of the statute is much more than this. It is to provide security for the citizens of the state who deal with the company and purchase its installment accumulation contracts. It should also be noted that the Maryland statute is not merely a deposit statute. In other words, the Maryland statute does not merely provide for a deposit of securities to be held as collateral for the performance of the com-

pany's obligations; it provides expressly for a transfer of title from the company and the creation of an actual trust for the benefit of designated persons. Most state statutes providing for the deposit of securities by insurance companies have been held to create express trusts for the benefit of designated policy holders of the company, *American United Life Ins. Co. v. Fischer*, 130 Fed. 2d 643, and in Maryland this is undoubtedly the case because the statute in express terms provides for a transfer of title and possession, and in addition expressly provides that the securities so transferred shall be held "in trust" for the designated beneficiaries. Even apart from the express language of the Maryland statute, it is clear under Maryland law that an express trust was created. *Casualty Insurance Company's Case*, 82 Md. 535.

The incidental provision of the Maryland law providing, among other things, for the liquidation of certain *specific securities* held in trust, upon the happening of certain contingencies and for payment to a *definite group* of its citizens, is not to be confused with a statute requiring that the *general assets* of a foreign corporation be liquidated in Maryland courts for the benefit of Maryland creditors of such corporation. Such a law might be considered a law on the subject of insolvency and therefore superseded by the federal bankruptcy statutes. But such is not this case.

It is true that the Federal Constitution grants to Congress the express power to enact uniform laws on the subject of bankruptcies, but to hold that Congress, under such power, could grant to the federal courts the power to set aside state statutes on matters of public policy passed in the exercise of the police power would be to

set at naught the whole theory of state sovereignty.[8] Consequently, it has been held that the express powers conferred upon the federal government by the Constitution are always subject to the implied limitation that the Congress in the exercise of such powers cannot transgress upon the rights of sovereign states.[9]

Thus, in *Ashton v. Cameron County District*, 298 U. S. 513, this Court, in holding the Municipal Bankruptcy Act invalid said: "The power 'To establish * * * uniform laws on the subject of Bankruptcies' can have no higher rank or importance in our scheme of government than the power 'to lay and collect taxes'. Both are granted by the same section of the Constitution, and we find no reason for saying that one is impliedly limited by the necessity of preserving independence of the States, while the other is not. * * * Like any sovereignty, a State may voluntarily consent to be sued; may permit actions against her political subdivisions to enforce their obligations. Such proceedings against these subdivisions have often been entertained in federal courts. But nothing in this tends to support the view that the Federal Government, acting under the bankruptcy clause, may impose its will and impair state powers—pass laws inconsistent with the idea of sovereignty." (298 U. S. 530, 531).

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[8] It may well be doubted whether Section 67(f) of the Bankruptcy Act (U. S. C. Tit. 11, Sec. 107(f)) added by Sec. 29(b) of the Investment Company Act of 1940, is constitutional in so far as it declares that deposits of securities made by a face amount certificate company pursuant to state law, shall be voidable as against the Trustee of the Debtor and to the extent it authorizes the Trustee to take possession of the securities. The question is not directly involved here inasmuch as Section 67(f), by its terms applies only to deposits to secure face amount certificates sold after January 1, 1941. In addition, it should be noted that the statute requires the Trustee for the Debtor to keep the deposited assets segregated and to distribute the proceeds thereof to the creditors entitled thereto under the provisions of the state laws.

[9] In *United States v. Perkins*, 304 U. S. 27, a similar statute was upheld, but the Supreme Court did not overrule the *Ashton* case and pointed out that in enacting the new law Congress was careful to avoid the objections to the previous statute set out in the opinion in the *Ashton* case.

And see *Hopkins Federal Savings and Loan Association v. Cleary*, 296 U. S. 315, 337.

The District Court, relying upon an article by Professor A. H. Feller entitled "The Tenth Amendment Retires", published in the April, 1941, issue of the American Bar Association Journal, assumed that the *Cleary* and the *Ashton* cases were overruled by this Court in *United States v. Darby Lumber Co.*, 312 U. S. 100. We respectfully submit that this Court has not done away with the Tenth Amendment as an effective precept in American Constitutional Law, as the title of Professor Feller's article would seem to imply, nor has this Court overruled the *Cleary* and *Ashton* cases, or the principles therein stated. Nowhere in its opinion does this Court refer to these two cases, and certainly there is nothing said in the opinion which questions the principles enunciated in them. In the *Darby* case no question of conflict between federal and state statutes was involved, but here the question involved is whether the power conferred upon Congress to establish uniform laws on the subject of bankruptcies is subject to the implied limitation that it must not unduly restrict or limit the exercise of their police power by the states, just as the power of Congress to levy and collect taxes is subject to the implied limitation that they shall not be a direct burden on the states. We respectfully submit that the bankruptcy power is subject to such a limitation.

The District Court in its opinion says: "The only respect in which the state statutes can be said to conflict with the Bankruptcy Act is that they give to state officials the right to retain custody of the deposits until final settlement or redemption of the Debtor's liabilities. If such provisions are in conflict with Chapter X of the Bankruptcy Act (a question which I do not deem it nec-

essary to decide at this time) * * * the provisions of the Bankruptcy Act must be held to be 'paramount to any state statute the effect of which may be to impair or emasculate them' ". (R. 201). In other words, it is claimed that the powers granted to the federal courts under the Bankruptcy Act are sufficient to enable them to override the plain provisions of the Maryland statute, the validity of which is not questioned. It is our contention that no such power is conferred by the Bankruptcy Act and that if Congress attempted to confer such a power upon the bankruptcy court, the statute would be in direct violation of the Tenth Amendment.

For these reasons we respectfully submit that the state deposit laws are valid and must be given full effect in the bankruptcy courts.

*2. The Securities Deposited With The Various State Officials Do Not Constitute Property Of The Debtor.*

It is our contention that the securities deposited with the various state officials do not constitute property of the Debtor, and hence are not subject to the jurisdiction and control of the bankruptcy court. For this reason the District Court had no authority to enter the turnover orders of June 6 and June 10, 1941, or the injunction order of August 9, 1941. However, the District Court held that "the assets deposited with the states remain assets of the Debtor and the maximum extent of the interest of the states in those deposits is that they be held in custody until the liabilities of the Debtor are redeemed or settled" (R. 200), that the various state officials are not adverse claimants, and that "the assertion of adverse claims, being merely assertion, and no more, may be disposed of summarily, as I have done" (R. 202). In other words, the District Court has decided that the cash and securities held by the Insurance Commissioner

of Maryland constitute property of the Debtor within the meaning of Chapter X of the Bankruptcy Act, and as a matter of fact it so declared expressly in the order of August 9, 1941, recognizing that otherwise there would have been no foundation whatsoever for the injunction.

Since this is a proceeding under Chapter X of the Bankruptcy Act, the power and jurisdiction of the District Court to enter the turnover orders and the injunction order must be found in some provision of that Act. The only provision relied upon by the petitioners is Section 111 (U. S. C. Tit. 11, Sec. 511), which provides that the bankruptcy court "shall, for the purposes of this chapter, have exclusive jurisdiction of the debtor and its property, wherever located". Consequently if the District Court had jurisdiction to enter the turnover and injunction orders, it must be on the ground that the securities held by the Insurance Commissioner of Maryland constitute "property of the Debtor" within the meaning of this section of the Act. We contend, however, that this is not true.

It must be borne in mind that the securities are not held merely as a pledge to secure the repayment of obligations of the Debtor to its contract holders. The Maryland statute shows clearly that title, as well as possession, is in the Insurance Commissioner of Maryland as the agent of the State of Maryland. The Maryland statute (Section 222) provides not merely that securities must be "deposited" with the Insurance Commissioner, but that such securities must be "assigned to" the Insurance Commissioner. This was done, and the securities are registered in the name of the Insurance Commissioner of Maryland as Trustee, so that unquestionably the legal title is vested in the Insurance Commissioner, and not in the Debtor.

It is also clear that not only is the legal title vested in the Insurance Commissioner of Maryland, but the equitable title to the cash and securities is likewise not vested in the Debtor, because the Maryland statute expressly provides that the "securities so assigned to and deposited with the Insurance Commissioner of Maryland shall be held by him in trust, as security for all the holders of contracts or other obligations heretofore or hereafter sold, negotiated, issued or accrued in said company in the State of Maryland."

In other words, the Maryland statute contemplates and requires the creation of an active trust in which the Insurance Commissioner of Maryland is the Trustee and the Maryland contract holders are *cestuis que trust* or beneficiaries. The legal title is in the Trustee, and the equitable owners of the securities are the Maryland contract holders. So long as there was no default, the Debtor was entitled to receive the income from the securities (Section 224), but upon default it lost even that right and had left to it only the right to receive any surplus that might remain after the securities had been sold and all obligations to contract holders in the State of Maryland had been paid in full. This bare right to receive such surplus, if any, does not constitute the securities themselves the property of the Debtor. In the first place, the interest of the Debtor in these securities is merely that of another beneficiary or *cestui que trust*, and as such it has no title or property right in the securities constituting the *res*. In addition, even this interest of the Debtor is subordinate to that of its Maryland contract holders, and the trust assets are not even subject to the expenses of administering the general assets of the Debtor. *Casualty Insurance Company's Case*, 82 Md. 535. Under such circumstances, how can it be said

that the securities constituting the trust *res* are the property of the Debtor? The Debtor was no more the owner of these securities than the settlor of a conventional trust is the owner of the property transferred by him in trust even though he might also be a beneficiary of the trust.

The situation is not at all the same as that existing where securities are pledged to secure a debt and the creditor has merely a lien upon the property. Even in such a case it might well be doubted whether such securities would constitute "property of the debtor" within the meaning of the Bankruptcy Act (see *In re Patten Paper Co.*, 86 Fed. (2d) 761), but it is not necessary for us to go that far in the present case because here the Maryland statute has clearly and explicitly created an express trust, has designated a Trustee, and has accurately and fully described the beneficiaries of the trust. It would therefore seem clear from a mere reading of the Maryland statute that the securities held by the Insurance Commissioner of Maryland do not constitute "property of the debtor".

There are several cases which support this contention and in so far as we are aware there are no authorities which hold that under a similar state of facts securities so held in trust would constitute "property of the debtor".

In the case of *In re Prudence Co.*, 82 Fed. (2d) 755, (cert. den., 298 U. S. 685), securities were deposited with trustees to secure bonds issued by the creator of the trust. An affiliated corporation guaranteed payment of the bonds and under the trust indenture had the right to service the securities constituting the trust *res* and collect the income therefrom so long as no default occurred in the bonds. Securities constituting the trust *res* had

originally belonged to the guarantor of the bonds and had been transferred by it to the corporation which created the trust and issued the bonds. A default occurred in the bonds and subsequently reorganization proceedings under the Bankruptcy Act were instituted against both corporations. The trustee appointed in the reorganization proceedings for the guarantor corporation asserted that as between it and its affiliate which had issued the bonds, the securities constituting the trust *res* belonged to the guarantor corporation. He therefore sought and obtained from the bankruptcy court an injunction restraining the trustees designated in the trust indentures from disposing of or taking any other action with respect to the securities constituting the trust *res*. The Second Circuit Court of Appeals held that even though the title of the guarantor corporation be assumed to be superior to that of the corporation which had issued the bonds, nevertheless, since a default had occurred, the guarantor corporation had lost all rights in the securities under the terms of the trust indentures, and therefore the Bankruptcy Court had no jurisdiction to enjoin or restrain the trustees from performing the duties imposed upon them by the respective trust indentures.

*Warder v. Brady*, 115 Fed. (2d) 89, is exactly in point. There a trustee for a debtor in a reorganization proceeding sought to obtain possession of certain monies which, pursuant to the order of a state court in a prior receivership proceeding, had been deposited by the debtor in a sinking fund to secure the repayment of certain obligations. The Fourth Circuit Court of Appeals, in holding that the sinking fund did not constitute property of the debtor, said: "A sinking fund under a bond mortgage is a trust fund, the title to which passes from the debtor

to the trustee who holds it for the benefit of the bondholders." See also: *Seaboard Terminals Corporation v. Western Maryland Railway Co.*, 108 Fed. (2d) 911.

The situation is not at all the same as that presented to this Court in *Continental Illinois National Bank and Trust Co. v. Chicago, R. I. & P. R. Co.*, 294 U. S. 648, so strongly relied upon by the Debtor in the Circuit Court of Appeals. There this Court upheld an injunction restraining the Reconstruction Finance Corporation and certain banks from disposing of securities held by them as collateral for the payment of obligations of the debtor corporation, but it appeared that the value of the securities held as collateral exceeded the debtor corporation's obligations secured by the collateral, by $28,000,000 in one case and $10,000,000 in another case. As a matter of fact the total value of all collateral was more than three times the total amount of the debtor corporation's obligations secured by the collateral. This Court held that the injunction was proper and necessary in order to protect these equities of $38,000,000 which equities, as this Court pointed out, constituted property of the debtor.

In the *Rock Island* case the assets in question were merely pledged and title thereto remained in the debtor corporation subject to a lien; here title to the assets in question passed completely from the Debtor prior to bankruptcy and was then and is now vested in a trustee. There the debtor corporation had a tremendous equity in the assets in question since the liens against the same amounted to less than one-third of the value of the assets; here the Debtor has no equity whatsoever in the trust assets and the value of the assets is actually less than the Debtor's obligations, the payment of which they secure. In the *Rock Island* case the injunction was upheld as a temporary measure to grant the debtor a reasonable

delay and opportunity to satisfy its obligations without a forced sale of the collateral; in the case at bar the court has not only enjoined a sale or other disposition of the trust assets, it has also declared that such trust assets constitute property of the Debtor. Certainly the *Rock Island* case is no authority for such action.

We also submit that the decision of the Circuit Court of Appeals for the Second Circuit in *Re Central Funding Corporation*, 75 Fed. (2d) 256, cited by the Debtor, is not pertinent. That case involved a turnover order entered after the approval of a plan of reorganization which was binding upon the beneficiaries of the trust and which provided for a termination of the trust. The order was entered pursuant to Section 227 of Chapter X which authorizes the court to require the execution of such instruments as may be necessary to effect a transfer of property dealt with by a plan which has been confirmed. In other words, the debtor and the beneficiaries of the trust entered into an agreement with respect to their mutual rights, which agreement provided for a termination of the trust and a transfer of the trust property to the debtor. The court merely required the trustee, who had no further interest in the trust property, to surrender the same in accordance with the plan. That is, of course, far different from the situation in the case at bar.

We respectfully submit, therefore, that the cash and securities held in trust by the Insurance Commissioner of Maryland for the Maryland contract holders of the Debtor do not constitute property of the Debtor. While we have been discussing this point primarily in connection with the Maryland statute, the same reasoning applies to the statutes of the other states, and it is our contention that none of the deposited securities consti-

tute property of the Debtor. This being so, the bankruptcy court has no jurisdiction or control over the deposited securities and not only can it not require the state officials to turn over the same to the trustee appointed in this proceeding, but neither can it enjoin the state officials from disposing of the deposited securities in accordance with the laws of their respective states.

### *3. The State Officials Having Possession Of The State Deposits Are Immune From The Judicial Process Of The Federal Courts Under The Eleventh Amendment To The Federal Constitution.*

The Eleventh Amendment to the Constitution of the United States provides that "the Judicial power of the United States shall not be construed to extend to any suit in law or equity, commenced or prosecuted against one of the United States by Citizens of another State or by Citizens or subjects of any Foreign State". The respondents contend that this provision of the Constitution is a direct prohibition against any suit or action, or other proceeding or order, summary or plenary, in the District Court or any other federal court to take possession of or exercise authority over the securities heretofore deposited with officials of the various states. On the other hand the petitioners contend that the Eleventh Amendment is not applicable because the turnover orders and the injunction order are not directed against any state as such, but only against the state officials as individuals.

It is true that these orders were not directed against any State by name and were directed only against certain named state officers, but they were directed against such state officers in their official capacities and the Eleventh Amendment covers "not only suits brought against a state by name, but those also against its officers, agents and representatives, where the State, though

not named as such, is nevertheless the only real party against which alone in fact the relief is asked, and against which the judgment or decree effectively operates". *Ex Parte Ayers*, 123 U. S. 505, 506. It has long been settled that the Eleventh Amendment will bar the action where the State officer or agent named as defendant has no personal interest in the controversy but is acting solely for and on behalf of the State. See *Louisiana v. Jumel*, 107 U. S. 711; *Cunningham v. Macon & Brunswick R. R. Co.*, 109 U. S. 446; *Hagood v. Southern*, 117 U. S. 52; *Murray v. Wilson Distilling Co.*, 213 U. S. 151; *Worcester County Co. v. Riley*, 302 U. S. 292; and *Read v. National Equity Life Insurance Co.*, 114 Fed. (2d) 977.

In the present case the State of Maryland, by valid statute, heretofore required the Debtor to assign to and deposit with the Insurance Commissioner certain securities to be held, in the language of the statute, "in trust, as security for all the holders of contracts or other obligations heretofore or hereafter sold, negotiated, issued, or accrued in said company in the State of Maryland". While the State of Maryland itself has no direct pecuniary interest in the securities so assigned to and deposited with the Insurance Commissioner, the legal title to said securities has passed from the Debtor and is now in the State of Maryland, or its agent the Insurance Commissioner, as Trustee for certain citizens of Maryland. The purposes of the trust are explicitly set forth in the statute, and the persons who are the beneficiaries thereof are clearly designated. The Trustee (the State of Maryland, or its Insurance Commissioner) has legal title and possession of the securities, and clearly, therefore, any action to obtain possession of the securities must be directed against the Insurance Com-

missioner, not in his private or individual capacity, but in his capacity as an agent of the State of Maryland. This being the case, the State of Maryland is the real party defendant.

This proceeding was instituted by the Debtor and the action of the Court in requiring the Insurance Commissioner of the State of Maryland to turn over, and in enjoining him from selling or otherwise disposing of the securities now held by him must necessarily be predicated upon the contention that the securities constitute property of the Debtor. But the title in the Debtor thus asserted is here disputed, and title to the securities in question is claimed by the Insurance Commissioner of the State of Maryland not as an individual, but as an officer of the State of Maryland. It is not possible to assert title in the Debtor without controverting the title of the State of Maryland and its officer. Since the State of Maryland, through its officer, has possession, any action to take possession away from it or to interfere with such possession is directed against the State of Maryland as the real party in interest. It is not necessary, in order to assert immunity from suit, that the State hold title for its own benefit. It is enough that title is in the State, or its officer, even though held by it or him as Trustee for the benefit of others. *Cunningham v. Macon & Brunswick R. R. Co.*, 109 U. S. 446.

*Lankford v. Platte Iron Works*, 235 U. S. 461, and the companion case of *Farish v. State Banking Board*, 235 U. S. 498, are squarely in point. There the State of Oklahoma had provided by statute for the creation of a depositors' Guaranty Fund to be sustained by contributions required to be paid by the banks in the State, the Fund to be disbursed for the purpose of liquidating deposits of failed banks. Administration of the Fund

was committed to the Oklahoma State Banking Board, and certain depositors of a failed bank filed suit in the federal court to require the Banking Board to pay their claims. This Court dismissed the action on the ground that the State Banking Board was immune from suit under the Eleventh Amendment, even though the contention was made that the Fund was not under the executive or legislative control of the State, and could be used solely for the purpose of paying depositors of failed banks; in other words, that the Fund was held in trust for private persons and the State had no pecuniary interest in it. This court held, however, that even if the Fund were not a State Fund, it was at least a Fund under the management of the State, through its officers, and that the federal court had no jurisdiction to subject the management of the Fund to judicial control.

The Debtor relied strongly upon *Hobbs v. Occidental Life Insurance Co.*, 87 Fed. (2d) 380, where it was held that an order requiring the Insurance Commissioner of Kansas to surrender certain securities to a federal court receiver of an insolvent insurance company was not a proceeding against the State of Kansas in violation of the Eleventh Amendment. However, the facts in that case were quite different from those in the case at bar. There the securities were held for the benefit of policy holders of the insurance company, all of whom were parties to the receivership proceeding. With the approval of the Court, an arrangement was made with another insurance company whereby it assumed all the liabilities of the insolvent insurance company and took title to all of its assets. This arrangement was approved by all except 28 out of 27,000 policy holders, and the 28 dissenting policy holders were paid the amount of

their claims. Thereafter the turnover order against the Insurance Commissioner was entered, but, as the Court pointed out, the insolvent insurance company had no further liabilities after the other insurance company had assumed all of the liabilities and the policy holders had acquiesced therein. Thus it appeared that the purposes of the deposit had been fulfilled and that the Insurance Commissioner was not acting in conformity with his state law in retaining the same.

In the *Hobbs* case the court distinguished the *Lankford* case on the ground that in the *Lankford* case title to the fund was in the State, even though the real beneficiaries of the fund were private persons. Here too title to the securities is in the State of Maryland, although the beneficiaries of the trust are citizens of the State, and it would, therefore, appear that the *Lankford* rather than the *Hobbs* case is analagous to the case at bar.

The District Court, apparently conceding that the State, through its agent, was a party, held that "here the state is only a nominal and not a real party in interest", and that since the order of August 9, 1941, did not affect the States' "political or property rights" the Eleventh Amendment was not applicable. But every distinction which the District Court points out could apply with equal force to the situation in the *Lankford* case and yet this Court held in that case that the suit was barred by the Eleventh Amendment.

The District Court cited only two cases in addition to the *Hobbs* case: *Morrill v. American Reserve Bond Co.*, 151 Fed. 305, and *Porter v. Beha*, 12 Fed. (2d) 513. The *Morrill* case was a case at nisi prius decided in 1907, eight years before the decision of this Court in the *Lankford* case, and much of the language of the court in that

case has been overruled by the decision in the *Lankford* case. The facts in the *Porter* case are quite different from those in the case at bar, but it is not necessary to discuss these facts in detail because the court there clearly pointed out the distinction between that case and the *Lankford* case when it said: "Of course, a state may prefer to pursue a position of ownership of assets of insolvent or embarrassed corporations, * * * but New York has not assumed that position."

In the present case the securities held by the Insurance Commissioner of Maryland were not merely deposited with him as collateral security for the payment of a debt, but title to the securities was actually vested in the Insurance Commissioner of the State of Maryland; not in the particular person who might for the time being hold that office, but in that officer of the State of Maryland. Obviously this is the same thing as saying that title was vested in the State of Maryland. It is true that the State held title not for its own benefit, but as Trustee; but hold title it did, and the securities were not only physically delivered but they were at all times registered in the name of the Insurance Commissioner of Maryland as Trustee.

We respectfully submit that the situation is exactly the same as that presented to this Court in the *Lankford* case, and that the decision in that case is controlling here.

***4. The Turnover Orders and the Injunction Order Were an Abuse of Discretion.***

The rights of the secured contract holders cannot be cut down (*Case v. Los Angeles Lumber Products Co.*, 308 U. S. 106; *Consolidated Rock Products Co. v. Du Bois*, 312 U. S. 510), and unless the state statutes are held to be wholly ineffective and to be completely disregarded

in determining the rights of the secured contract holders, no possible advantage can be gained by enjoining the various state officials from liquidating the trust property in their hands and making a distribution thereof to the beneficiaries of the trust. On the other hand, there is an ever present danger that delay will result in serious loss to the secured contract holders by depreciation in the value of the securities held in trust for them by the state officials in their respective states. Accordingly, even if it be assumed *arguendo* that the turnover orders and the injunction order were not void under the Eleventh Amendment and that the District Court had a discretionary power to enjoin disposition of the deposited securities pending the outcome of the reorganization proceeding, we nevertheless submit that the District Court abused its discretion in entering the turnover orders and the injunction order under the circumstances of the case.

As pointed out by Mr. Justice FRANKFURTER in *Railroad Commission v. Pullman Co.*, 312 U. S. 496, 500-501: "Few public interests have a higher claim upon the discretion of a federal chancellor than the avoidance of needless friction with state policies, whether the policy relates to the enforcement of the criminal law * * *; or the administration of a specialized scheme for liquidating embarrassed business enterprises * * *; or the final authority of a state court to interpret doubtful regulatory laws of the state * * *. These cases reflect a doctrine of abstention appropriate to our federal system whereby the federal courts, 'exercising a wise discretion,' restrain their authority because of 'scrupulous regard for the rightful independence of the state governments' and for the smooth working of the federal judiciary. * * * This use of equitable powers is a contribution of the courts in furthering the harmonious relation between

state and federal authority without the need of rigorous congressional restriction of those powers." See also *Palmer v. Massachusetts*, 308 U. S. 79, 89.

Had the District Court followed these precepts, it never would have entered an *ex parte* order requiring duly constituted officials in 15 states to turn over and surrender to a trust company in Charleston, West Virginia, over twenty million dollars of securities which had been deposited with such officials by Fidelity pursuant to the laws of their respective states. Such an order was clearly entered in complete disregard of the rights and duties of such state officials with respect to the deposited securities.

Not only have the federal courts restrained their authority because of "scrupulous regard for the rightful independence of the state governments", but the Congress also has wisely refrained from giving even the federal bankruptcy courts authority over certain kinds of business enterprises which are strictly regulated by the states and supervised by means of extensive administrative machinery set up under state statutes. It was for this reason that insurance companies, banks, and similar companies were excluded from the provisions of the Bankruptcy Act. For similar reasons, the Congress, although authorizing the bankruptcy courts to reject executory contracts, excepted "contracts in the public authority".[7]

[7] Sections 116(1) and 216(4) of Chapter X of the Bankruptcy Act (U. S. C. Tit. 11, Secs. 516(1) and 616(4)). It might well be contended that the state statutes are in the nature of contracts between Fidelity and the respective states, since Fidelity could enter said states and transact business therein only in accordance with the terms and provisions of such statutes. Having transacted business pursuant to the statutes, Fidelity accepted the terms and provisions thereof, including the provisions with respect to deposits. These contracts are executory in the sense that the obligation of the Debtor to maintain the market value of the trust *res* still exists even though the Debtor has discontinued the sale of its contracts, and are also executory in that the trusts created by the contracts have not yet terminated and will not terminate until the payment of all obligations of the Debtor to contract holders in the respective states.

Even if it should be determined that Fidelity was not an insurance company, it was nevertheless in that class of corporations which are extensively regulated by the states. The federal courts, even if not prohibited from so doing by the Eleventh Amendment to the Constitution of the United States, should be extremely loath to issue turnover orders or injunction orders directed against state officials requiring them to turn over securities, or enjoining them from disposing of securities deposited with them pursuant to state law by such corporations.

These considerations have particular weight in situations such as that here presented where, if the state deposit laws are accorded that validity and effectiveness which neither the petitioners nor the Securities and Exchange Commission deny, the surrender of the state deposits to the Trustee for the Debtor would be an utterly futile act since the securities making up the deposits would be sold and the proceeds thereof turned over to the same contract holders who would have received the money had the deposits not been surrendered. The only thing accomplished would be a liquidation by the Trustee for the Debtor rather than by the duly constituted and experienced state authorities acting pursuant to their respective state statutes. If the contract holders in the respective states are ultimately to receive their distributive shares of the securities deposited in their states for their protection (which would clearly be the result unless the state deposit laws are to be entirely abrogated) why raise grave constitutional questions involving the respective spheres of the state and federal governments to accomplish a futile end? At the same time there would be no benefit to the contract holders but only loss and inconvenience caused by the unnecessary

delay and by requiring them to travel many hundreds of miles from their homes in order to vindicate their rights.

We, therefore, respectfully submit that even if the District Court did have a discretionary power to enter an injunction order, it should have stayed its hand in order to avoid a needless conflict with state policies, as exemplified by the various state deposit statutes affecting Fidelity.

*Summary.*

We earnestly urge that the fundamental issue presented by this case is whether the federal courts of bankruptcy have such jurisdiction and control over securities deposited by debtor corporations with state officials pursuant to valid state regulatory laws as to empower the bankruptcy courts to seize such state deposits and thereby, in effect, abrogate the state statutes. If not, then this proceeding is at an end because it is idle to talk of reorganizing the Debtor without having control of the state deposits. We submit that the state deposit laws are valid regulatory statutes which cannot be superseded by any supposedly "paramount" powers of the bankruptcy courts, that the Eleventh Amendment bars any attempt by the bankruptcy courts to require the state officials to surrender the state deposits, and that the state deposits are not property of the Debtor. We also respectfully submit that even aside from these considerations it was an abuse of discretion, under the circumstances of this case, for the District Court to enter the turnover orders and the injunction order, and that due regard for the delicate nature of the relationship between the federal courts and the states should have caused the District Court to stay its hand.

## II.

### THE PETITION OF THE DEBTOR SHOULD BE DISMISSED BECAUSE IT IS UNREASONABLE TO EXPECT THAT A PLAN OF REORGANIZATION CAN BE EFFECTED.

Section 141 of the Bankruptcy Act (U. S. C. Tit. 11, Sec. 541) provides that "Upon the filing of a petition by a debtor, the judge shall enter an order approving the petition, if satisfied that it complies with the requirements of this chapter and has been filed in good faith, or dismissing it if not so satisfied." Section 146(3) of the Bankruptcy Act (U. S. C. Tit. 11, Sec. 546(3)) provides: "Without limiting the generality of the meaning of the term 'good faith', a petition shall be deemed not to be filed in good faith if * * * (3) it is unreasonable to expect that a plan of reorganization can be effected." It is our contention that it is unreasonable to expect that a plan of reorganization of Fidelity can be effected and that, therefore, the petition of the Debtor should have been dismissed.

*The Findings of the Courts Below.*

The District Court in that portion of its opinion dealing with this issue (R. 194-197) apparently proceeded on the assumption that not only was the burden on the respondents to establish that it was unreasonable to expect that a plan of reorganization of the Debtor could be effected, but that it was incumbent upon the respondents to show that it would be *impossible* to reorganize Fidelity. Under the law, however, the burden is upon the Debtor to sustain this issue and it is incumbent upon the Debtor to prove that it is not unreasonable to expect that a plan of reorganization can be effected. *Marine Harbor Properties, Inc., v. Manufacturers' Trust Co.*, No. 24, this Term, decided November 9, 1942.

On the evidence before it the District Court found that the prospects for the rehabilitation and continued operation of the Debtor were to say the least far from promising. The court said: "The proceedings are not yet at a stage where the court is called upon to consider any particular plan of reorganization. It is true that the broad picture developed by the testimony at the hearing does not present a very favorable view with respect to the rehabilitation and continued operation of the Debtor as a face amount certificate company. Whether the Fidelity plan is fundamentally unsound depends upon the definition given to that term. It is apparent that it is a plan of investment which yields a very low rate of income to the investor and subjects the investor to substantial loss should he cease to pay the required installments during the early stages of the contract; but this very element of weakness from the investor's standpoint strengthens the company from an operating viewpoint, provided the contracts can be sold in sufficient volume to take care of the necessary overhead expenses. It is extremely doubtful whether, in view of unsettled economic conditions and the critical international situation, the Fidelity plan would any longer appeal to a large public; but it is not impossible; and it is not the duty of the court to decide for the public that investors will not or should not buy these contracts in the future." (R. 194-195).[8]

Viewing the situation in an entirely different light, the Circuit Court of Appeals, after stating the conclu-

[8] This last conclusion of the District Judge is at variance with the general rule stated in Finletter, The Law of Bankruptcy Reorganization, pp. 62 and 63, as follows: "The nature of the business of the debtor is important in determining feasibility. A public utility or large industrial company with a prosperous history carries with it almost a presumption of the necessity for its continuance as a going concern. On the other hand the courts will inquire carefully into the feasibility of a reorganization of an enterprise of no public importance which has not proven that there is a demand by the public for its product."

sions of the District Court, said: "This resumé of the District Judge presents a dark picture of the company's future. Nevertheless, it suggests that some plan of reorganization not yet formulated, much less proposed by any person financially able to carry it into effect, may not be impossible. We think it is our duty to review the situation realistically, and when this is done, there appears to be no reasonable hope of a reorganization of the business as a going concern, but only the immediate need of a liquidation of the company's assets for the benefit of the contract holders. Obviously there will be nothing left for the stockholders. * * * Moreover, as the District Judge points out, it is quite doubtful whether this form of investment presents any further appeal to a public that has now been informed as to the nature of the business; certainly the possibility that thousands of contract holders could be persuaded to modify their contracts and scale down their claims to enable the company to go on is so remote as to exist only in the imagination. No proposal for the investment of new capital has been forthcoming." (R. 259-260).

***Contentions of the Petitioners.***

As a matter of fact the Securities and Exchange Commission in the argument before the Circuit Court of Appeals admitted that there was virtually no hope whatsoever for the rehabilitation and reorganization of Fidelity as a face amount certificate company or as any other kind of going concern; they frankly stated that liquidation was practically inevitable. And even in this Court the Securities and Exchange Commission does not seriously argue that Fidelity can be reorganized as a going concern; they, in fact, admit that the possibility of its rehabilitation as a going concern is "negligible". (S. E. C. brief, p. 46). On the other hand, the Debtor and the

Trustee, still holding fast to the illusion that somehow, in some way, Fidelity can be reorganized, refuse to give up hope and argue that there is "much testimony of qualified witnesses that in the opinion of such witnesses Fidelity can be reorganized". In support of this argument they refer to the testimony of seven witnesses. In order to show clearly the essential weakness of the testimony thus relied upon, we have printed as Appendix B to our brief, excerpts from the testimony of these witnesses which show its vague nature and the wholly insufficient reasons given by each of the witnesses for his opinion. In a large measure this testimony speaks for itself and needs but little comment.

The witness D. A. Burt, a stockholder of Fidelity, did testify that in his opinion Fidelity could be reorganized but his testimony clearly shows that he was expressing a fond hope rather than an intelligent opinion (App. B, p. 30). He admitted that a number of problems existed in connection with any possible reorganization and that he had not made any study of the matter; and he refused point-blank to indicate any opinion as to what form a reorganization should take. He recognized that new capital would be required but offered no suggestions as to how it could be raised. He also thought the present stockholders ought to have some equities in the new company. He talked a great deal about the supposed advantages of the Fidelity plan and pointed out that he and other members of his family had purchased contracts, but when asked whether he or any of the members of his family still owned such contracts at the time of the institution of this proceeding he said he didn't know.

The witness Hubert F. Young, an employee interested in keeping his job, also testified that in his opinion

Fidelity should be reorganized and offered three suggestions: (1) that a mutual insurance company be formed, (2) that a new company with new capital take over the liabilities under the contracts on the basis of the liquidating value of the various funds, and (3) that Fidelity merge with another insurance company. However, he admitted that he did not see much possibility of a merger and offered no suggestions as to how the new capital could be raised although he admitted that under the Investment Act of 1940 a capital of $50,000 was required of old companies, and $200,000 of new companies. He finally indicated that he had in mind some vague idea of creating a capital structure by reducing the liabilities to the contract holders to 70% or 80% of the full amount. When pressed about the hazard to contract holders in investing funds of the company in semi-speculative and speculative securities, he replied: "Well, if they didn't they would probably lose their money some other way in my opinion." (App. B, p. 87).

Auditor Sims testified that when he had filed the bill of complaint for the appointment of receivers in the Circuit Court of Kanawha County he had "hoped" that the company could be reorganized and had a "thin and nebulous" idea that in some way the "company could be mutualized and turned over to the contract holders". On the other hand, he expressed the very emphatic opinion that Fidelity could not be reorganized as an annuity company, and pointed out that "twenty-six of the biggest insurance companies in the last five years have lost $66,000,000 on annuity contracts". (App. B, p. 88).

The witness H. Isaiah Smith indicated clearly that he was not qualified as an expert to express an opinion and that his personal opinion that Fidelity should be reorganized was based solely upon the fact that "with

the assets the size that Fidelity has, a reorganization of some sort can be done". He further indicated that he had no idea what kind of a plan could be worked out and that he did not know whether any plan could be worked out which would be approved by two-thirds of the creditors or contract holders. He had only the vaguest idea of what might be accomplished and frankly admitted that he had not tried to work out even an outline of a plan of reorganization. (R. 483).

The witness Allen G. Messick, in a broad general way, indicated that in some way not explained by him Fidelity could be reorganized. This was the same man who had been brought into the company for the specific purpose of putting it on its feet and raising new capital and who had for two years tried, without success, to reorganize it. At one time, in company with another individual, he entered into a contract with Fidelity to furnish additional capital of $500,000 but, for reasons of his own, failed to carry out the contract. Certainly the testimony of such a witness is entitled to no consideration.

The witness Raymond Latta, an actuary, had been employed in 1940 by Fidelity for the specific purpose of assisting in working out some plan of reorganization. He had made tentative studies as to several proposed plans of reorganization, none of which were carried to fruition and all of which contemplated a reduction in the claims of the contract holders. He did not testify that in his opinion Fidelity could or should be reorganized. As a matter of fact the District Court refused to permit him to express his opinion on this question and insisted that he was qualified only to express an opinion as to whether or not it was actuarily possible to formulate a plan of reorganization (R. 1105-1106). As to this, the answer of the witness was in the affirmative because, as he pointed

out (App. B, pp. 91-92), almost anything is actuarily possible. The record shows that if he had been permitted to express his opinion, he would have testified that it was unreasonable to expect that a plan of reorganization could be effected and that the Debtor can never be reorganized either as a face amount certificate company or as a life insurance company.

The witness Howard E. Reed, another employee, whose duties had been to make speeches promoting the Fidelity plan, expressed the opinion that Fidelity could be reorganized but he indicated that the only basis for his opinion was "purely from the sales standpoint". He thought there was a great field for the Fidelity contract (R. 737). His opinion was influenced by the fact that he thought the Franklin Life Insurance Company was doing well in the sale of annuity contracts (R. 735-736); and yet the Vice-President of the same Franklin Life Insurance Company later testifying on behalf of the respondents stated that that company had undertaken to sell a contract very similar to the Fidelity contract, had instituted an aggressive sales campaign similar to that conducted by Fidelity, had employed a number of the salesmen who had been with Fidelity, but had found results very disappointing (R. 1016-1018). He further pointed out that the Franklin sales volume on this contract reached a peak of $300,000 in April, 1941, but by June, 1941, with the Defense Bond program competing very seriously, it had dropped to $100,000 and had been below that ever since (R. 1018).

Mr. John E. Marshall, Sr., large stockholder, general counsel and prime mover in Fidelity's affairs for a number of years, testified "I have not any idea of the plan, have not worked on the plan, and don't feel that I am competent to work on it. I have hoped some plan could

be worked out * * * I would not even sit here as a witness and say a plan could be promulgated * * *" (R. 420).

The witness Henry M. Steussy who had had long experience in selling Fidelity contracts, testified that in his opinion Fidelity could not be reorganized (R. 1027-1028, 1039-1040).

The witness Tom Foulk, General Attorney for Fidelity, testified that in his opinion Fidelity could not be reorganized. He said: "I felt that so far as an investment company was concerned that we were done. I couldn't see any possibility to carry on in the investment field. We couldn't qualify and go ahead under the Investment Act of 1940, and I felt that that type of business had had its day * * *" (R. 944-946).

Even at this late date, after having had complete charge of the Debtor's affairs for twenty months, and with full opportunity to make such investigations as might be necessary, neither the Trustee nor the Debtor are able to present even an outline of a proposed plan of reorganization, nor are they able to suggest in any tangible way what kind of a plan of reorganization might possibly be effected. The most they are able to do is to suggest three possibilities: (1) that some insurance or investment company might be found to take over or buy the assets of Fidelity and issue to Fidelity contract holders investment certificates or insurance policies which might be worth more than the contract holders would get through liquidation, (2) that a beneficial merger might be worked out with some other investment company or insurance company, and (3) that the organization of some kind of a mutual company is not beyond the realm of consideration. (Debtor-Trustee's brief, pp.

47-48). It is argued that these are "suggestions" supported by the record, and "thoughts" which should not be relegated to the realm of mere possibilities as distinguished from probabilities until there has been some opportunity to transform them into realities (Debtor-Trustee's brief, p. 48). However, not only does the record not support these "suggestions" and "thoughts", it clearly refutes them.

The Debtor's own witness Hubert F. Young, made it clear that there was no basis for hope that some other insurance or investment company would buy Fidelity's assets or be interested in a merger with Fidelity, because, as he pointed out, Fidelity had no advantage to offer to any other company (R., 631). The same opinion was expressed by the witness Steussy who said Fidelity "has lost that which a company taking it over is after—the sales organization. It has disappeared, disassembled and disintegrated" (R. 1027-1028). And is it not reasonable to suppose that if there were any possibility of a merger with another investment company or insurance company, that some such company would certainly have long since communicated with the Trustee and suggested such a merger?

The Debtor and the Trustee infer that an insurance company could issue to each of the contract holders of Fidelity; insurance policies which would be worth more than the contract holders would receive in liquidation and they conclude that such an arrangement would afford the contract holders the benefit, in whole or in part, of the cost of selling the insurance. Not only is there no evidence whatsoever to support this conclusion, but a moment's reflection will indicate clearly that it is false. In the first place, no insurance company could issue policies to all the contract holders without regard to their

insurability, and in the second place, no insurance company could issue to a contract holder an insurance policy in any amount greater than his equity would buy on the basis of the ordinary insurance rates applicable to him. In other words, the contract holder would get no more than if he took his dividend in liquidation and made his own independent purchase of insurance.

The suggestion is also made that at least "the solvent funds or series of Fidelity contracts might be reorganized" and the statement is made that the Series A, B, C, and D funds are solvent (Debtor-Trustee's brief, pp. 46, 48). But, as pointed out by the Securities and Exchange Commission (S. E. C. brief, p. 8) the solvency of the funds depends upon the extent to which their inter-fund accounts receivable are collectible assets, so it cannot be stated that there is any one fund which is definitely solvent. In addition, the Debtor's suggestion is based upon the assumption that the state deposits will be entirely disregarded because otherwise it is not possible to talk about reorganizing one or more of the Fidelity funds or series. The state deposits cut across all series funds and the series fund theories advanced by the Debtor and the Trustee are untenable unless the rights of the contract holders with respect to the state deposits can be eliminated from consideration.

We respectfully submit that not only has the Debtor failed utterly in meeting the burden of proving that it is not unreasonable to expect that a plan of reorganization can be effected, but all of the evidence demonstrates beyond peradventure of a doubt that it is unreasonable to expect that a plan of reorganization can be effected.

Actually, neither the Debtor nor the Trustee nor the Securities and Exchange Commission have any real hope that Fidelity can be reorganized either as a face amount certificate company or as an insurance company. Their main reliance is upon the contention that "a slow, orderly and unified" liquidation is a method of reorganization within the meaning of Chapter X of the Bankruptcy Act. The Circuit Court of Appeals did not pass upon this question because it concluded that if liquidation were inevitable, the interests of the contract holders would be best subserved in the state court proceedings. The District Court, however, did conclude that "it is not necessary that there be a reasonable prospect for the successful rehabilitation of the Debtor as a going or continuing corporation. It is sufficient if it is shown that the Debtor is in a position to conform to and obtain the benefits of the statute for a slow, beneficial and orderly liquidation." (R. 196).

There are two clear answers to this contention: (1) that a "slow, beneficial and orderly liquidation" is not a plan of reorganization within the meaning of Chapter X, and (2) that even if a plan providing for the creation of some sort of liquidating corporation to conduct a slow and orderly liquidation of the Debtor's assets could be considered a plan of reorganization within the meaning of Chapter X, nevertheless there has been no showing in this case that any such plan is necessary or would be beneficial to the contract holders, or that it is reasonable to expect that any such plan could be effected.

We will not in this brief attempt to argue fully the first point because we understand that it will be fully discussed in the Wisconsin-Iowa brief. We do wish to

point out, however, that liquidation is the antithesis of reorganization and it would indeed seem anomalous to use a statute expressly adopted for the purpose of providing the machinery for reorganization of corporations as a vehicle to accomplish the liquidation of a corporation, particularly when the Bankruptcy Act itself provides other machinery for the liquidation of insolvent corporations. In addition, Section 236 of Chapter X (U. S. C. Tit. 11, Sec. 636) specifically provides that if no plan of reorganization is consummated, the judge may either direct that bankruptcy be proceeded with, or dismiss the proceeding under Chapter X. If liquidation can be accomplished under the guise of a plan of reorganization under Chapter X why authorize the court to direct that bankruptcy be proceeded with or to dismiss the petition for reorganization if no plan is consummated? It should also be observed that Section 146(3) of Chapter X would be virtually nullified if a slow and orderly liquidation could be deemed a plan of reorganization because there could always be a plan providing for liquidation and it would, therefore, never be unreasonable to expect that such a plan could be effected.

The petitioners argue that Section 216(10) of Chapter X (U. S. C. Tit. 11, Sec. 616(10)) provides that a plan of reorganization may include the sale of all or any part of the debtor's property and the distribution of all or any of its assets, or the proceeds derived from the sale thereof among those having an interest therein. But we submit this is not the effect of Section 216(10). Section 216 sets out a number of things which *must* be included and some things which *may* be included in any plan of reorganization, and paragraph 10 of this section requires that a plan "shall provide adequate means for the execution of the plan, which may include", among

other things, the sale of all or any part of the debtor's assets. This is not at all the same as saying that a plan providing for the sale of all of the assets and the distribution of the proceeds thereof is a plan of reorganization. Paragraph 10 merely gives broad power for the consummation of a real plan of reorganization and the portions thereof relied upon by the petitioners should be read in connection with paragraph 7, which requires that a plan shall provide for any non-accepting creditors "adequate protection for the realization by them of the value of their claims against the property dealt with by the plan" either by the transfer or sale or retention by the debtor of the property subject to the claims, or by a sale of such property free of claims, at not less than a fair upset price. In other words, the portions of paragraph 10 relied upon by the petitioners are merely included to carry into effect those provisions which must, under paragraph 7, be included in a plan in order to fully protect non-assenting lien creditors.

Aside from these considerations, the contention of the petitioners that it is not unreasonable to expect that a plan of reorganization can be effected because there is a necessity for a slow and orderly liquidation which can be accomplished only through the means of a proceeding under Chapter X, is without foundation. There is no special problem in disposing of the assets of the Debtor in spite of what might be said as to the rating of the securities deposited with the various states. The deposited securities constitute 95% of the assets of the Debtor and with the possible exception of some few securities deposited with the Insurance Commissioner of West Virginia, all of them are readily marketable. Of the remaining 5% of the assets, one-half is represented by cash and the other one-half by tangible assets. Only

about $350,000 or $400,000 of assets, or approximately 2% of the total assets, is represented by real estate. Certainly this is no indication that a *slow* liquidation is required. Certainly there is no necessity of continuing this proceeding under Chapter X merely in order to work out a plan to liquidate assets, practically all of which are readily marketable securities.

We, therefore, respectfully submit that even if it were admitted, for the purposes of argument, that under some circumstances a slow and orderly liquidation might be deemed a plan of reorganization, certainly this is not such a case, and there has been no showing whatsoever that there is any necessity for a slow and orderly liquidation by means of some new corporation to be created for that purpose, and no showing whatsoever that any such course of action would be in the slightest degree beneficial to the creditors of Fidelity.

## III.

### THE PETITION OF THE DEBTOR SHOULD BE DISMISSED BECAUSE IT APPEARS THAT THE INTERESTS OF THE CREDITORS WOULD BE BEST SUBSERVED IN THE PRIOR PENDING STATE COURT PROCEEDINGS.

Section 146(4) of Chapter X of the Bankruptcy Act (U. S. C. Tit. 11, Sec. 546(4)) provides: "Without limiting the generality of the meaning of the term 'good faith', a petition shall be deemed not to be filed in good faith if * * * (4) a prior proceeding is pending in any court and it appears that the interests of the creditors and stockholders would be best subserved in such prior proceeding."

It is conceded by all parties that the stockholders have no further interest in Fidelity, and it is likewise conceded that the West Virginia state court proceeding and other state court proceedings were prior pending.

proceedings. Accordingly, if it appears that the interests of creditors would be best subserved in such prior pending state court proceedings, then the Debtor's petition was not filed in good faith, and it should have been dismissed.

***Contentions of the Petitioners.***

Most of the petitioners' argument on this point is directed to a showing that the proceedings in the several state courts are not under any reorganization statute, and that there is no single prior pending state court proceeding, that is, that there is no one state court having jurisdiction over all of the assets of Fidelity. It is said that the prior pending state court proceedings are mere equity receiverships and that all of these proceedings lack the safeguards provided by Chapter X of the Bankruptcy Act. A number of "safeguards" which it is argued are of benefit to the contract holders of the Debtor, are referred to (Petitioners' brief, pp. 53-54), but it will be noted that with possibly two exceptions all of them pertain to the preparation, submission and approval of a plan of reorganization and would, therefore, be pertinent only if there were some hope of reorganization. The only safeguards which could possibly be said to have any bearing apart from a plan of reorganization, are the report to creditors as to the value of their respective interests, and "the independent appraisal of the assets of the Debtor's estate by the Securities and Exchange Commission". As to the first, it is sufficient to say that a report to creditors showing the extent of their interests is not peculiar to Chapter X, and we think we can safely say that all creditors will be advised of their interests in the Debtor's assets and the value thereof, in the pending state court proceedings. With respect to the suggested independent appraisal by the Securities and Exchange Commission of the Debtor's

assets, we can say merely that not only do we find no provision in Chapter X for such an appraisal or valuation by the Securities and Exchange Commission, but the Securities and Exchange Commission has not indicated in this proceeding that it has the facilities for making such an appraisal or that it will undertake to do so. As a matter of fact, practically all of the assets consist of securities, which do not present any difficult problems of valuation. The remaining assets are largely real estate, which constitute possibly 2% of the Debtor's assets.

It is true that none of the prior pending state court proceedings were instituted under the provisions of any state reorganization statute. We would also be willing to concede, for the purposes of argument, that if it were reasonable to expect that a plan of reorganization (as distinguished from a plan of liquidation) could be effected, the "safeguards" provided by Chapter X and relied upon by the petitioners might well be considered in determining whether the interests of creditors would be better subserved in the proceeding under Chapter X or in the prior pending state court proceedings. *Marine Harbor Properties, Inc. v. Manufacturers' Trust Co.*, No. 24, this Term, decided November 9, 1942. But here, where there is no real hope of a reorganization, and when it is practically conceded that liquidation is not only inevitable but is for the best interests of the contract holders, these safeguards have no real bearing. They are important only if there is a reasonable prospect that a plan of reorganization can be effected. If there is to be a liquidation, then there will be no plan of reorganization to be reported on by the Securities and Exchange Commission or approved by the court.

The Circuit Court of Appeals held, largely on the basis of the findings of fact of the District Court, that it was

clearly not feasible to rehabilitate the Debtor as a going concern. The court referred to the fact that this was virtually conceded by the District Court and by the Debtor, the Trustee, and the Securities and Exchange Commission, and it pointed out that the only suggestion made by these parties was that it was feasible to have a "slow and orderly liquidation" in the federal court and that such a "slow and orderly liquidation" was a method of reorganization within the meaning of Chapter X (R. 260). The Circuit Court of Appeals clearly did not pass on the question of whether a "slow and orderly liquidation" was a method of reorganization, but instead held (1) that the record did not justify the conclusion that it was reasonable or feasible or desirable to have a "slow and orderly liquidation" in the federal court, and (2) that since liquidation was inevitable, the question then arose as to whether the interests of the creditors would be best subserved by such a liquidation in the federal court, or by liquidation in the state courts (R. 261-263).[9]

The issue then is not whether Fidelity can best be *reorganized* in a proceeding under Chapter X or whether the state court proceedings will better serve that purpose since liquidation in some form is inevitable, the issue is simply whether the interests of the creditors can best be subserved by a liquidation in the federal court or by a liquidation in the prior pending state court proceedings.[10] We strongly urge that not only is there a com-

[9] The Securities and Exchange Commission apparently concurs in this construction of the opinion of the Circuit Court of Appeals. Brief, pp. 28-29.

[10] Of course, as we have pointed out in the argument under Section 146(3), the whole idea of liquidation is completely antagonistic to any concept of reorganization. This being the case there never would be any issue of whether the interests of creditors would be best subserved by a liquidation in the federal court or a Chapter X proceeding. If liquidation appears inevitable, the proceeding should be dismissed under Section 146(3). We, therefore, discuss the point on the same basis the Circuit Court of Appeals did, that is, by assuming *arguendo* without conceding, that liquidation may be a form of reorganization.

plete failure on the part of the Debtor to show that it was reasonable or feasible or desirable to have a "slow and orderly liquidation" in the federal court (*supra*, pp. 35-56), but the record shows clearly that the interests of the contract holders would be best subserved by a liquidation in the pending proceedings in the courts of their respective states.

***The Contentions of the Securities and Exchange Commission.***

The Securities and Exchange Commission argues that a liquidation in the federal court rather than in the state courts, is desirable because there are too many state court proceedings, and there is a necessity for a central administration of the Debtor's assets. Three reasons are urged in support of this contention: (1) "the necessity for impartial investigation" of the acts of management of the Debtor, (2) "the necessity for a single administration to settle problems of marshalling assets and of distribution", and (3) "the necessity of orderly procedure to liquidate the assets". Keeping in mind that we are here considering the desirability of a central administration of a *liquidation* in the federal court, as compared with *liquidation* in the state courts, we will discuss each of these points.

1. *"The necessity for impartial investigation."* It is stated that "there are strong indications in the record that extravagance and other serious mismanagement mark Fidelity's history", and it is said that an investigation of possible civil actions on behalf of Fidelity's estate against the officers, directors, and perhaps others, is desirable. Assuming the truth of these statements, we submit that such an investigation is clearly secondary to the principal objective, namely, the liquidation of the state deposits for the benefit of contract holders as expeditiously as possible. There would seem to be no

reason whatsoever why the liquidation and distribution of the bulk of the assets to contract holders should be delayed pending an investigation of whether there exist possible civil actions against former officers and directors of the Debtor. Certainly nothing would prevent a liquidation and distribution of the bulk of the assets to contract holders now, and an investigation now or later as to whether they have any such civil rights of action.

It is suggested, however, that problems of venue and jurisdiction would present obstacles to civil suits at the instance of state officials in every state but West Virginia, and that the "interlocking relationships among the officials of Fidelity and the receivers and their counsel" are such as to indicate that there would be no adequate investigation and prosecution of causes of action against Fidelity's management by the officers appointed by the West Virginia state court. Without conceding that it would not be possible for investigations to be made and suits to be instituted at the instance of other state courts, we respectfully submit that there is no justification whatsoever for the inference that the Circuit Court of Kanawha County, West Virginia, would be remiss in its duty and would not appoint impartial disinterested persons to conduct such investigation as might be necessary and to prosecute such suits as might be proper.

The Securities and Exchange Commission and the petitioners treat the matter as though the question were whether such investigations could best be conducted by the Central Trust Company, or by Mr. H. Isaiah Smith and Mr. Ross B. Thomas, the West Virginia state court receivers. But we submit that this is not at all the issue. The question is not whether the interests of the creditors will be better protected by the Central Trust Company than by the present West Virginia state court receivers;

the question to be decided is whether the interests of the creditors will be better protected by the federal court or by the Circuit Court of Kanawha County, West Virginia. In initially appointing receivers, Judge Bouchelle of the Circuit Court of Kanawha County, was careful to appoint as one of the receivers a man who had broad previous experience, who had held responsible public positions with honor, who was respected for his honesty and integrity, and who had had no previous connection whatsoever with Fidelity. That Mr. H. Isaiah Smith is such a man is demonstrated by the fact that immediately upon the appointment of Central Trust Company as Trustee herein Mr. Smith, with the approval of the District Court, was employed to aid and assist it in performing its duties as Trustee. He has continued in the employ of the Trustee and, with the possible exception of investment problems, has supervised virtually all of the Debtor's affairs for the Trustee.

No one suggests that Mr. Smith would not be capable of making the impartial investigation which is deemed desirable, but it is contended that his co-receiver, Mr. Ross Thomas, is not in a position to do so because of his previous relationships with Fidelity. But this contention completely ignores the fact that in appointing Mr. Thomas as co-receiver, Judge Bouchelle did so solely because of his familiarity with Fidelity's affairs and his previous broad experience in corporate reorganization matters. Judge Bouchelle had been told that an effort would be made to work out some sort of voluntary partial reorganization of Fidelity, and he appointed Mr. Thomas to aid in this aspect of the receivership, at the same time stating that if it later appeared that no such voluntary plan of reorganization could be worked out, Mr. Thomas would be discharged as receiver. This in-

formation was communicated to the District Court by a letter from Judge Bouchelle and there is no reason to suppose that he will not carry out his announced purpose.

The argument of the Securities and Exchange Commission and the petitioners comes simply to this. Because Mr. Ross B. Thomas was appointed one of the receivers for Fidelity by the West Virginia state court, it is now necessary that all the contract holders throughout the country be required to present their claims to the federal court at Charleston, West Virginia, many miles from their homes, and that the proceedings pending in the courts of their own states, which are conveniently located and readily accessible to them, and which would provide a prompt distribution of the assets deposited with their state officials for their protection, shall now be abandoned. We respectfully submit that such a course of action could hardly be said to be in the best interests of the creditors.

2. *"The necessity for a single administration to settle problems of marshalling assets and of distribution."* It is suggested that there is a "complex task of disentangling the assets of each of the several series in order that they may be properly and effectively marshalled." It is assumed that the reserve funds of each series and the securities in which they were invested were effectively segregated as separate trusts and that the contract holders must be divided into classes by series and their claims limited to the assets which may ultimately be determined to belong to their particular series. At the same time it is recognized that there was no real segregation and it is urged that before distribution can be made "the accounts of the various funds *inter sese* must be settled". Such a theory of course ignores the fact

that pursuant to valid state laws, 95% of the assets of Fidelity have been deposited with various states as security for the contract holders of Fidelity, and if the validity of the state deposits is recognized, the series fund theory of distribution must necessarily fall. (*supra*, p. 52). Also, this theory ignores the fact that there is no contract provision for a segregation of reserve funds except possibly with respect to Series B, C and D. (*supra*, p. 14). Series C has only one contract holder (R. 492) and Series D is also comparatively small and was sold only in four states (R. 315).

It is further suggested "that there is a problem whether states may retain securities accepted in disregard of knowledge or notice that the assets deposited belong to particular series funds and were deposited to secure liabilities of other series", and that "should this issue be decided adversely to the states in question, these states might not be able to retain their entire deposits". Here again several erroneous assumptions are made: (1) that states did accept securities for deposit with knowledge or notice that such securities belonged to particular series funds, and (2) that if so, such securities were improperly deposited and, therefore, cannot now be retained.

We have already shown (*supra*, pp. 9-11) that it is not true that the reserve funds and the securities purchased therefrom were actually segregated by Fidelity. On the contrary, the record shows clearly that although separate books were maintained for the B, C and D series, no actual segregation of securities purchased from the reserve funds of these series was ever even attempted until very recent years, and that even when some little attempt was made to segregate the securities, it was found to be utterly impossible. The record also clearly

shows that even if the state laws had permitted separate series deposits and if initially these deposits had been segregated by series, it would have been impossible for Fidelity to function and to have kept separate deposits for each series (R. 586, 608-609, 652).

Likewise, there is no foundation for the statement that the state officials accepted deposits of securities with knowledge that the securities belonged to one particular series fund. We have shown above (*supra*, pp. 9-10) that none of the securities were earmarked or in any way identified with a particular fund when they were originally deposited. The securities were deposited with the state officials as one general deposit and there was no effort made to advise the state officials that the securities belonged to one series fund or another (R. 586-587).

But even if there had been notice to the state officials at the time securities were deposited that they had been purchased from particular reserve funds, this would not mean that such deposits would now have to be surrendered. None of the state laws provide for a segregation of deposits by series funds. All deposits were in fact general deposits and all of the state laws seem to contemplate only general deposits for the benefit of *all* contract holders in the state. The idea is advanced that the so-called "improper" deposits can be recaptured on some theory of tracing trust funds, but it must be remembered that the state laws must be read into the contracts as a part thereof and provisions of the contract which are inconsistent therewith must fall. If the state laws do not provide for deposits segregated by series, and for separate trusts, then any provisions in the contracts purporting to create such separate series trust funds cannot be given effect so as to defeat the purpose or requirements of the state deposit laws.

As a matter of fact, all of the contracts specifically provide that the reserve funds shall be invested in securities which shall be deposited in trust as required by the laws of the State of West Virginia. The laws of the State of West Virginia provide for the deposit of the securities in one trust for the benefit of all contract holders except to the extent that securities have been deposited in other states for the protection of contract holders in such states. The contract, therefore, specifically provides not for deposits in trusts segregated as to separate series funds, but deposits in trust pursuant to state deposit laws. The only separate trusts provided for are the trusts for the contract holders in the states which require such deposits in trust.

It is also urged that there may be some conflicts of interest between resident and non-resident contract holders in respect to the deposits in each state and that, therefore, in order to avoid giving the resident contract holders an advantage, both the resident and the non-resident contract holders should be compelled to litigate their rights in the federal court at Charleston, West Virginia. This is certainly a novel proposition. What possible justification is there to require Maryland contract holders to go to the expense and inconvenience of litigating in West Virginia their rights in the Maryland deposit merely because it is possible that residents of Pennsylvania, for instance, may assert some sort of claim adverse to that of the Maryland residents? We completely fail to see the equities of any such procedure. The Maryland contract holders of the Debtor bought their contracts in reliance upon the Maryland law and in the belief that the Debtor deposited in Maryland securities of a sufficient value to protect them (R. 536-537, 921, 936-937, 1048). Contract holders in states not requiring de-

posits bought their contracts in reliance upon West Virginia law and the deposit with the Treasurer of West Virginia. What possible equitable principle would compel the Maryland contract holders to give up their securities and litigate their right thereto in a court four hundred miles from their residence merely because the other contract holders who relied on the West Virginia law and the West Virginia deposit must assert their claims in West Virginia?

3. *"The necessity of orderly procedure to liquidate the assets."* The argument that one centralized administration is necessary and essential for the orderly liquidation of the Debtor's assets is based upon the false premise that each state depositary will separately proceed to liquidate immediately "without regard to the overall effect of simultaneous sale", and also fails to take into account that regardless of the rating of the securities held by Fidelity, all of the securities deposited with all of the states, with the possible exception of West Virginia, are readily marketable, that the only securities which might not be readily marketable are deposited with the Treasurer of West Virginia and that the only other assets, such as real estate, which might not be quickly marketable are located in the State of West Virginia.

Assuming that the sale and liquidation of the deposited securities requires careful handling and special supervision, what reason is there to suppose that each state official will proceed to liquidate immediately without regard to the overall effect of simultaneous sale. As said by the Circuit Court of Appeals: "The liquidation in every state in which deposits were made will be subject to the supervision of established governmental departments, as well qualified for the business as the trustee

in bankruptcy. There is every reason to believe that the liquidation under their supervision will proceed without needless expense in a careful and expeditious manner so as to save as much as possible for the contract holders" (R. 262).[11] It may be assumed that the state courts supervising the sale of the deposited securities by the state officials and the state receivers will require the liquidation and sale of such securities in an orderly manner so as to realize as much as possible therefor without at the same time running the risk of losing large sums of money by reason of fluctuations in security markets.

Since all of the assets which might be considered not to be readily marketable are concentrated in the West Virginia assets and all of them would come under the control of the Circuit Court for Kanawha County, West Virginia, or the Insurance Commissioner of West Virginia in the event this proceeding were dismissed, there would be only one central administration of, or supervision over the sale of such assets, the only difference being that the administration would be in the West Virginia state court instead of in the West Virginia federal court.

***The State Laws Should Be Construed by the State Courts.***

The argument that a centralized administration of all of the securities deposited with the various state officials is necessary in order to determine judicially the numerous questions alleged to exist with respect to the rights of the various contract holders, is likewise based on a

[11] Shortly after the decision of the Circuit Court of Appeals directing the dismissal of the Debtor's petition, representatives of all 15 states holding deposited securities met in a conference at Charleston, West Virginia, to discuss plans for the liquidation of the state deposits. It was agreed at this meeting that the respective states would not undertake to sell their securities without first advising and consulting with the other states, and that the various state officials having charge of the sale of the securities constituting the state deposits would cooperate in order to bring about the most advantageous sales and to avoid depressing the market for the securities.

false premise. It is argued that if these various questions are determined by the state courts, fourteen or fifteen separate judicial determinations will be required, and the assumption is made that if there is centralized administration there will be only one judicial determination of one legal question. But of course this is not true. Centralized administration as contended for by the appellees would mean that there would be but one forum for the determination of these numerous legal questions alleged to exist, but there would still have to be a separate judicial determination as to the rights of the contract holders in each of the different states where deposits were maintained by the Debtor. In other words, in the one case there would be fourteen of fifteen legal questions judicially determined by as many courts; in the other case, there would be the same number of legal questions to be judicially determined, but the determinations would be made by one court.

No advantage can possibly accrue by having these various questions determined in one forum. The determination of these questions depends upon a construction of the various state statutes, a construction of the contracts of the Debtor, and a consideration of the actions of the Debtor and its contract holders with respect to state deposits. But there is no federal law governing such matters. *Erie Railroad v. Thompkins*, 304 U. S. 64. On the contrary, all of such matters are governed by state law, and consequently the rights of the contract holders in one state will differ from the rights of the contract holders in other states to the same extent as the laws of those states differ. If this be an inconsistency, it is one which cannot be avoided, and would exist regardless of whether the ultimate decision was made in the federal court or in the various state courts.

Since this is the situation, it seems to us that it would be more desirable to have the Court of Appeals of Maryland, for instance, decide what the Maryland law is with respect to contracts of the Debtor sold in this State, and what the rights of the Maryland contract holders of the Debtor are with respect to the securities held in trust for them by this appellant, rather than have the Federal Court at Charleston undertake to determine how the Court of Appeals of Maryland would construe and apply the Maryland law.

The desirability of following this procedure and the extreme reluctance of the federal courts to construe state statutes or determine matters of state law, particularly in the absence of applicable state decisions, has recently been forcefully emphasized by this Court. In *Thompson v. Magnolia Co.*, 309 U. S. 478, this court held that although "a court of bankruptcy has an exclusive and non-delegable control over the administration of an estate in its possession", nevertheless "the proper exercise of that control may, where the interests of the estate and the parties will best be served, lead the bankruptcy court to consent to submission to state courts of particular controversies involving unsettled questions of state property law and arising in the course of bankruptcy administration." (p. 483). Acting on this principle this Court directed the District Court to require the trustee in bankruptcy to submit to the Illinois state courts the question of the fee simple ownership of a right-of-way.

In *Railroad Commission v. Pullman Co.*, 312 U. S. 496, this Court reversed the decision of a three-judge court construing a Texas statute, and held that the question of state law should not be determined by the federal court but should be submitted to the state court for decision. This Court said: "The lower court did deny that the Texas statutes sustained the Commission's assertion

of power. And this represents the view of an able and experienced circuit judge of the circuit which includes Texas and of two capable district judges trained in Texas law. Had we or they no choice in the matter but to decide what is the law of the state, we should hesitate long before rejecting their forecast of Texas law. But no matter how seasoned the judgment of the district court may be, it cannot escape being a forecast rather than a determination. The last word on the meaning of Article 6445 of the Texas Civil Statutes, and therefore the last word on the statutory authority of the Railroad Commission in this case, belongs neither to us nor to the district court but to the supreme court of Texas. In this situation a federal court of equity is asked to decide an issue by making a tentative answer which may be displaced tomorrow by a state adjudication (R. 499-500). See also *Beal v. Missouri Pacific Railroad Co.*, 312 U. S. 45, 49-50; *Watson v. Buck*, 313 U. S. 387, 402; *Chicago v. Fieldcrest Dairies, Inc.*, 316 U. S. 168, 171-173; *Texas v. Donoghue*, 302 U. S. 284; 54 Harvard Law Review 1379.

We respectfully submit that these considerations apply with particular force in a case such as this where not only are there present questions as to the interpretation and meaning of state statutes, but where the statutes involved are regulatory measures enacted pursuant to the public policy of the states to protect and secure their citizens dealing with companies selling securities, and where the questions also involve the title and right to possession of millions of dollars of securities now in the possession of the duly constituted officials of such states. Such a situation is indeed one where the federal courts might well "restrain their authority because of scrupulous regard for the rightful independence of the state governments and for the smooth working of the federal judiciary" (312 U. S. 501).

## CONCLUSION.

We earnestly contend that the petition of the Debtor was not filed in good faith and should have been dismissed because: (1) the state deposits are not subject to the jurisdiction and control of the bankruptcy court, and without control of the state deposits there is no possibility of reorganizing the Debtor; (2) it is unreasonable to expect that a plan of reorganization of the Debtor can be effected; and (3) the interests of the creditors would be best subserved in the prior pending state court proceedings.

For these reasons we respectfully submit that the judgment of the Circuit Court of Appeals for the Fourth Circuit was correct and should be affirmed.

Respectfully submitted,

GUY B. BROWN,
H. VERNON ENEY,
Counsel for the Respondent,
John B. Gontrum, Insurance Commissioner of the State of Maryland.

# APPENDIX A.

## MARYLAND STATUTES.

The Laws of Maryland relating to companies selling installment accumulation contracts were enacted by Chapter 530 of the Acts of the General Assembly of Maryland of 1931, and are now codified as Sections 218 to 234, inclusive, of Article 48A of the Annotated Code of Maryland (1939 Edition) title "Insurance", sub-title "Installment Accumulation Contracts". We have printed below only the sections which are pertinent in this case and have shown only the descriptive title of the sections not printed in full.

Several of the following sections were amended in certain particulars by Chapters 121 and 639 of the Acts of the General Assembly of Maryland of 1941, effective June 1, 1941. The amendments are not pertinent in this case and have not been reproduced here.

218. (Definitions.) Whenever used in this sub-title the following shall be construed as follows:

The term "company" when used in this sub-title shall be deemed to include any individual, firm, partnership, association, trust, including a common law trust, corporation heretofore or hereafter formed under the laws of this State or any other State or territory of the United States or any foreign State or country.

The term "contract" when used in this sub-title shall include any bond, note, certificate, obligation, annuity agreement or passbook evidenced by writing, or other agreement to pay money.

The term "Commissioner" when used in this sub-title shall mean the Insurance Commissioner of the State of Maryland.

219. (Licenses.) No company shall hereafter engage or continue, either directly or indirectly, in the business of issuing, negotiating, offering for sale or selling any contract payable on the installment plan with or without definite maturity dates which contracts contemplate the accumulating of money or funds for making loans or investments and undertaking or agreeing to pay or deliver at any future time any sum of money, contract, or other thing of value, without first having obtained a license as provided in this sub-title.

Every company desiring to obtain a license under the provisions of this sub-title shall file with the Commissioner an application in writing in such form as may be prescribed by him. In case of a foreign company there shall be filed with the Commissioner a copy of its charter, declaration of organization or deed of settlement, if there be such, duly certified by the proper officer of its home state. Such foreign company shall also file with the Commissioner a power of attorney, appointing the Insurance Commissioner of the State of Maryland as agent or attorney for the company, upon whom process of law may be served, together in the case of a company having directors with a certified copy of the vote or resolution of the directors appointing such attorney. Said writing or power of attorney shall stipulate and agree on the part of the company making the same, that any lawful process against said company which is served on such agent shall be of the same legal force and validity as if served on such company within this State, and also that in the case of death or absence of the attorney so appointed, service of process may be made upon the Deputy Insurance Commissioner. Said power of attorney cannot be revoked or modified, so long as any obligations of the company remain outstanding in this State. The term "process" used above shall be held and deemed to include any writ, summons or order whereby any action, suit or proceeding shall be commenced or which shall be issued in or upon any action, suit or proceeding by any court, officer or magistrate. Every company

shall further file with the Commissioner a statement of the condition of the company on the 31st day of December next preceding.

Before a license shall be issued by said Commissioner, he shall make or cause to be made an investigation of the conditions and affairs of the applicant and its general plan of operation. If the Commissioner is satisfied that the company is sound and is being operated in such a manner as to afford proper protection to the holders of its contracts heretofore or hereafter entered into, he shall issue a license to said company authorizing said company to solicit, negotiate, sell and dispose of its contracts in the State of Maryland until July first next following, which said license may be renewed from year to year by the Commissioner upon payment by the company of the fees hereinafter provided for in this sub-title. If the Commissioner is not satisfied that the applicant company is sound or that it is being conducted in such a way as to afford proper protection to holders of contracts heretofore or hereafter entered into, he shall forthwith notify the applicant to that effect, and upon request from such applicant filed within ten days after receipt of such notice, the Commissioner shall fix a time and place for hearing, of which ten days' notice shall be given to such applicant, at which hearing the applicant may offer such information and evidence relating to its application as it may deem proper. If satisfied as aforesaid, as a result of said hearing, the Commissioner shall thereupon issue a license, but if the Commissioner is not satisfied, as aforesaid, then he shall refuse such license.

220. (Revocation of Licenses.)

221. (Right of Appeal.)

222. (Deposits Required.) No company licensed under the provisions of this sub-title shall at any time offer, negotiate, or sell contracts in the State of Maryland, unless and until such company *shall have assigned*

*to and deposited with* the Commissioner, or with some independent trust company approved by him, *in trust, as security for all the holders of contracts or other obligations heretofore or hereafter sold, negotiated, issued or accrued in said company in the State of Maryland,* bonds, coin or treasury notes of the United States of America, or interest or dividend paying bonds or stocks of this or any other State of the United States or of any county, incorporated city or other corporation of this or any other State having legal authority to issue the same and not in default, or other securities approved by the Commissioner, *having a market value of not less than $25,000, and at no time less than the aggregate contract liability of the company under all contracts heretofore or hereafter sold in the State of Maryland;* provided that in the case of a non-resident company which shall annually produce a certificate of the insurance commissioner or other proper financial officer of the State in which such company is organized, setting forth that such company has deposited with him securities having a market value of not less than $25,000 and not less than the aggregate contract liability of the company to the holders of all contracts or other obligations heretofore or hereafter sold, negotiated, issued or accrued by said company in the United States, and that he holds said deposit in trust and on deposit, under and by the laws of the State in which he resides for the benefit of all the contract holders of such company in the United States, and that he is satisfied that the securities so deposited by such company and held by him are worth not less than $25,000 and not less than the aggregate contract liability of the company to the holders of all contracts or other obligations heretofore or hereafter sold, negotiated, issued or accrued by said company in the United States, then in such case such company shall be excused from making the deposit hereinbefore required. When the value of said securities shall depreciate so that the market value of the deposit shall be less than hereinbefore required, additional securities shall be deposited in order that the deposit shall at all times be

maintained in the amount of not less than that hereinbefore required. (Italics supplied.)

223. (Exchange and Surrender of Deposits.) Any deposit of coin, treasury notes or securities as aforesaid made, may at any time be withdrawn by the company making the same, under such rules and regulations as the Commissioner may reasonably make, provided other securities authorized by law and of at least equal value shall be substituted therefor. Whenever it shall appear to the satisfaction of the said Commissioner with whom any deposit shall have been made as aforesaid that the aggregate amount of the liability of the company under its contracts heretofore or hereafter sold in the State of Maryland is less than the value of the securities so deposited, then to the extent of such surplus over the amount of $25,000, the said Commissioner shall permit said Company to withdraw a portion of said deposit. Whenever a company shall discontinue the negotiation or sale of its contracts in the State of Maryland, it shall notify the Commissioner in writing, and the Commissioner shall thereupon cancel the license of such company, and at any time thereafter upon the furnishing of proof satisfactory to the Commissioner that the obligations of the company under its contracts theretofore negotiated or sold in the State of Maryland have been satisfied in full, then said company may withdraw the deposit of securities required by this sub-title. If upon such discontinuance the company furnished proof satisfactory to the Commissioner that the liability of the company under contracts theretofore sold in the State of Maryland cannot in the future equal the amount of the securities deposited under the provisions of this section, then with the approval of the Commissioner the surplus over such possible liability may be withdrawn. If at any time this sub-title be repealed and a law be enacted in the State of Maryland governing the licensing, supervision and regulation of companies engaged in the sale in the State of Maryland of contracts of the kind and character covered by this sub-title, then the securi-

ties deposited under the provisions of this sub-title may be withdrawn by the company.

224. (Sale of and Income From Deposits.) All deposits made under the provisions of any of the preceding sections shall be held by said Commissioner subject to sale and transfer and to the application of the proceeds of any such sale only on the order of a court of competent jurisdiction. So long as a company shall be solvent and not in default under any section of this sub-title, it shall be entitled to receive the income from any deposit made under any preceding section.

225. (Annual Statement.)

226. (Publication of Revocation or Refusal to Renew License.)

227. (Examination of Companies.)

228. (Production of Books, etc.)

229. (Liquidation of Insolvent or Illegally Conducted Companies.) Whenever the Commissioner shall have reason to believe that any company is insolvent, or fraudulently conducted, or that its assets are not sufficient for carrying on the business of the same, or during any non-compliance with the provisions of this sub-title, it shall be his duty in addition to revoking the license of such company to proceed against it as provided by Sections 52 to 63, both inclusive, of this Article, for the liquidation of insolvent or fraudulently conducted insurance companies.

230. (Proceedings to Vacate Charter.)

231. (Fees.)

232. (Penalties.)

233. (Exceptions.) The provisions of this sub-title shall not apply to any company engaged in the business of issuing, negotiating, offering for sale or selling contracts wherein the liability under such contracts is adequately secured in advance of sale by the lien or pledge

with an independent trust company of property, real or personal, nor to any company engaged in the business of issuing, negotiating or offering contracts for the sale of securities where no payment is made to said company except upon the contemporaneous delivery by said company to or for the account of the purchaser of the securities agreed to be sold, nor to any domestic or foreign banks, banking institutions, banking companies, savings institutions, trust companies, safe deposit companies, insurance companies, building and loan associations, nor to contracts issued by a company for the purpose of raising money for its principal business, if its principal business is other than the issuing or negotiating or selling of contracts or obligations described in Section 219 of this sub-title.

234. (Severability Clause.)

# APPENDIX B.

## EXCERPTS FROM TESTIMONY OF DEBTOR'S WITNESSES.

### D. A. BURT.

(R. 708-709):

The Court: I would like for you to go a little further and say what type of organization you have in mind, when you say that you believe it can be done. A. The first thing, of course, is to get a plan of such character that new capital can be obtained. If that plan is actuarily sound, and, as I said, meets the approval of the Securities and Exchange Commission and of the Auditor of this State, I think the capital can be found. If the general fund of the company is improved by the addition of a large amount of capital—and I admit that is a large amount—the contract holders are infinitely better off than they would be in the event of liquidation.

Q. Well, it is your idea that it should be continued as a face amount certificate company solely or some other form or a combination of more than one form of business? A. I don't know, Your Honor. It would seem to me a committee on reorganization would have to work that problem out with the supervisory authorities. I understand some of them object to that type of contract. If that is the case, the contract would have to be so modified as to meet their desires.

* * * * * * *

(R. 715):

Q. My point is this, Mr. Burt. I think your answer has given me partially the answer that I want, but you are not prepared to say, are you, that Fidelity should again engage in the selling of face amount certificates as a sole business? A. I won't answer that. That is a matter for the committee and the SEC and the Auditor to work out.

Q. And I say, you are not prepared to say that, in your opinion, it should engage in that business alone, are you? A. Not without a great deal of study.

Q. Which you have not—— A. Which I have not made.

* * * * * *

(R. 718):

Q. You answered, I believe, as I understood you, that you thought the present common stockholders ought to have some equities in the new company? A. Merely future earnings, if there are any.

Q. Sir? A. Merely future earnings, if there are any.

Q. What form would those equities take that you have in mind? A. Might take the form of——

Q. I can't hear you, Mr. Burt. A. I don't know whether the Investment Act would permit it or not, but I would think a no-par security of some sort.

Q. Voting rights? A. Yes.

Q. Voting rights. Will you speak out just a little bit louder. It seems to me like I am a little hard of hearing. Have you gone into the situation and are you familiar with the situation of this company with respect to deposits of securities in the different states—— A. No.

Q. (Continuing) Securing these contracts? A. No.

* * * * * *

(R. 720-721):

Q. Now, suppose, Mr. Burt, that under the laws of some twelve states other than the State of West Virginia there are, as I have put in my previous question, about ten million dollars of these assets being held to secure the liabilities of this company to contract holders who have their money in it, would you think that a plan that involved the cutting down or reducing of the claims of those contract holders—those secured contract holders—in those deposited funds would likely meet with their approval? A. There again you are getting back to the plan. Now, I am not going to discuss the plan. That plan will have to be worked out by a committee, and it

will have to meet the situation, and if it is approved, as I said, I think the contract holders in all the states will be so glad to have it, rather than a liquidation, that more than sixty-six and two-thirds per cent will approve it.

Q. I understand that you would agree with me that in forming an opinion as to the reasonableness and the prospect of a plan of reorganization, that we have to weigh the present situation with which we are dealing with respect to the assets of the company and how the assets are held. A. The committee will do that.

Q. You mean that you don't think that you should do that in expressing an opinion as to whether or not there should be a reorganization? A. No, I don't think so. This plan is in the air yet; it is not formulated; it depends on a great many factors, including state laws and national laws and the approval of supervisory boards, and I am not going to attempt to make a plan on this witness stand.

Q. I think you recognized that there was a need for a considerable amount of new capital? A. Yes.

Q. How much new capital do you think would be needed? A. I don't know. It changes from time to time; our securities list is up and down. We are at the moment in an advancing market. As soon as this tax bill is finally passed, investment funds will probably come out. There is a reasonable hope, at least, that securities will sell higher in six months than they are doing today. The portfolio might appreciate somewhat. I don't know what this committee might face.

Q. Do you know at the present time how much the deficiency is—— A. I do not.

Q. Well, wait. You haven't heard my question. A. Pardon me.

Q. Do you know at the present time how much the deficiency is between the reserves—invested reserves—and assets of the company—on the outstanding contracts—and the cash liabilities or reserve liabilities of the contract holder. A. I do not.

Q. Sir? A. I do not.

Q. You didn't know that that was about at least as much as $2,600,000? A. I did not. I understand——

Q. In your opinion, would there be a fair chance of reorganization, of getting the approval of the Auditor of the State of West Virginia and the Securities and Exchange Commission and two-thirds of these contract holders—these secured contract holders—to a plan of reorganization that did not bring up these reserves to the liabilities of the company, reorganizing it as a solvent company? A. There is again your plan. You are trying to get me to discuss the plan, which I will not discuss.

Q. Then you recognize that there is a problem of getting the new capital? A. Certainly.

* * * * * *

(R. 723-724):

Q. Did you own any contract at the time this company went into receivership? A. I don't know.

Q. Sir? A. I don't know.

Q. When was the last time you held a contract? A. I don't know that.

Q. Can you look that up and tell us? A. I don't know whether I can or not.

Q. How much did you ever hold? (No answer.)

Q. Well, I will ask you to do this. I see you are pausing—— A. I don't know. I had several contracts. Some I bought for my children and some for Mrs. Burt, but I can't tell when I bought them or what I paid on them.

Q. I want to ask you to do this, please sir. During the noon hour, to look up the information and then give it to us after lunch, the dates and amounts of all the contracts that you or any member of the family of you bought and the dates when you cashed them in, if you cashed them in.

Mr. Ray: Your Honor, that is an unreasonable request. Mr. Burt lives in Wheeling. Undoubtedly all his records are at Wheeling and I don't think those things have any place in this case at all.

Mr. Farmer: Could you get that for us, Mr. Burt?

The Court: Mr. Farmer, that would have pertinency only to the extent whether Mr. Burt owned any contract at the time of the receivership, and possibly whether he had cashed in any contracts before their maturity prior to the receivership. If you will confine it to that, I will admit it.

Mr. Farmer: I had in mind, if the Court please, it was a very practical test of his faith in this sort of savings institution.

The Witness: Not necessarily.

Mr. Farmer: I just thought that would be some test.

The Witness: Not necessarily. I might have needed some money.

Mr. Farmer: Well, can you get that information for us, Mr. Burt? A. I don't think I can.

* * * * * * *

HUBERT F. YOUNG.

(R. 631):

Q. In your opinion, from your knowledge and experience with the operations of Fidelity and your general business experience, what is your judgment in reference to the feasibility of rehabilitating Fidelity through a proper plan of reorganization? A. I think it could be done and should be done.

Q. Will you explain that to the Court, please? A. Well, in my opinion there are two ways it can be done. One is by making an insurance company mutualized; the contract holders would own the company. One other way, the only way I know to have a face contract company, have a new company with new capital absorb the various contracts, with liability on a fair basis, to be arrived at by market value and liquidating value of the various funds; and one reason I think it should be done I think 1938 was the largest sales of any year we ever had. As I recall it, we went at the rate of fifty to sixty million dollars face value. Those people who bought then have not had an opportunity of paying long enough to get a

reasonable amount of money back on their investment. I think they should be allowed to continue to pay in, on a proper basis of course.

Q. What would you think about a third possibility of merging, say with an insurance company, and continuing to write annuity contracts but also engage in business in the general insurance field? A. Well, that would be my idea, if we had a mutual insurance company, except not to merge. I don't know what advantage we could show to some other company, just offhand, probably could—why they should merge with us.

Q. Could that be done either with a stock company or mutual company? A. I think that could be done with either, except in a mutual company you are giving your contract holders something for giving up something. I think we all know they will have to give up something, and they should be given some kind of compensation.

* * * * * *

(R. 671):

The Court: By the changes you speak of, do you refer, perhaps, to a scaling down of loading or some other feature that would render the expense of selling the contracts less and thereby increase the profits? A. I think that there would have to be a contribution made by the contract holders of the various series and especially the ones that are insolvent, and that the others should be asked to reduce the required amount presently required to redeem them.

* * * * * *

(R. 796-797):

Mr. Palmer: There is one other thing, I do not believe it was brought out by Mr. Young before that one of the requirements of the Investment Companies Act was a net capital of $50,000, and Fidelity, having no capital, but being minus a million and a half, it couldn't go ahead under that Act. A. That is the chief reason we couldn't qualify.

Q. Unless it got new capital? A. Unless it got new capital, but under present conditions that was the chief stumbling block.

The Court: How much capital? A. $50,000 in an old company. A new company requires $200,000.

Mr. Jaegerman: If the contract liabilities of Fidelity were reduced so it had $50,000 for capital, I suppose that would also comply, would it? A. It would comply, yes.

* * * * * *

(R. 799-800):

Q. Now, you talked about a plan that you had here, and as I caught it your plan contemplated cutting down these old contracts, these special annuity and special income contract holders. A. I didn't say I had a plan. I said that was one of the possibilities of working into a plan.

Q. You said first it might be made an insurance company. A. I said that is possible.

Q. Do you know any insurance company that would undertake to issue policies to these contract holders, who have not been selected on any basis of risk, either age or sex or physical condition? A. I didn't say I would give them an insurance policy. We would give them an insurance annuity.

Q. And cut down on the existing reserves that they have now? A. Possibly. Those are details.

Q. You would have to do that? A. Would you? Well, you answer that.

Q. You said you were going to cut them down about 20 per cent, didn't you? A. I didn't say I was going to cut them down at all. I said that was one possibility.

Q. Didn't you say by cutting them down to about 80 per cent it might be done? A. I possibly did, 80 or 70 or whatever it works out.

Q. If you will assume with me that there are some twenty million dollars of assets in this company, or better than that, which could be distributed among contract holders on the basis of their cash surrender values at the present time—cash liabilities at the present time—of about twenty-three million dollars, they could get that amount out of liquidation if you just sold them out and distributed the money, couldn't they? A. I doubt it,

after years of liquidation expense and the expense of litigation I don't think they would get anything like twenty million dollars.

Q. That would depend on court expense? A. Yes, and you don't know what kind of market you are going to have by the time you liquidate. It would take quite a while, in my opinion, to liquidate. It might drive the market down to the bottom when you start to liquidate, and instead of getting 70 per cent you might get 50.

Q. Those are conditions that you think might reduce the amount? A. Easily.

Q. But what you are proposing to do is to cut down these old contract holders whose contracts at maturity would have to be much lower than 80 per cent wouldn't it? A. Sure it would.

Q. And then invest the funds of this company in semi-speculative and speculative securities? A. Well, if they didn't they would probably lose their money some other way in my opinion.

Q. Did you ever hear of Mr. Ponzi? A. Yes, I have heard of him.

Q. He had his plan, didn't he? A. Do you think that is comparable to ours?

* * * * * *

## EDGAR B. SIMS.

(R. 454):

Q. Mr. Sims, let me see if I understand you. The structure of the company economically and financially was unsound from the beginning; is that right? A. Yes, they promised too much in the twenties.

Q. And never could have succeeded? A. Not at that rate they were promising.

Q. No matter about the extravagance or anything else; if run economically it was bound to be condemned; is that right? A. I think so. I think they were quarreling with Ray's arithmetic all the time back there; and there was another reason it was doomed to failure. They had bought German government bonds, Mexican bonds and

second mortgage bonds and fourth mortgage bonds, and of course, they are not worth much.

* * * * * *

(R. 455-456):

Q. And you said also that you would not license any company that might be built upon the corpse of this company to write installment contracts in West Virginia, did you not? A. That is what I said.

Q. Suppose the company was reorganized out of new cloth entirely. Do you feel that you would—— A. (Interposing). I just doubt——

Q. Just a minute, now. Supposing it was reorganized out of new cloth entirely, a reorganization that was authorized after this matter had gone through the Federal Court, under Chapter 10, do you still say you would not grant it a license to operate in West Virginia? A. I don't understand what you mean when you put that verb in the past tense, or the past perfect tense—"was reorganized".

Q. Well, I will say "will be reorganized". A. Organized by whom; and how much money will be put in it? I want to know that before I could answer that. I am not going to permit it to be organized on thin air.

Q. You can answer it or not, Mr. Sims. A. I think it inadvisable to relicense the company to sell these contracts exclusively. Twenty-six of the biggest insurance companies in the last five years have lost $66,000,000 on annuity contracts.

* * * * * *

(R. 457):

Q. Well, Mr. Sims, you filed a petition in the Circuit Court of Kanawha County, did you not? A. Yes, sir.

Q. You filed that under the statute which gave you the right to do it? A. Yes.

Q. In that petition, you asked for dissolution or reorganization, did you not? A. Yes, sir.

Q. You proposed, when you filed that bill of complaint, to reorganize the affairs of this association through the Circuit Court of Kanawha County? A. That was what I had hoped to do.

Q. Then you do think it can be reorganized? A. Not as an annuity company alone.

Q. Part annuity? A. I have serious doubts about the annuity business in any form.

The Court: How did you intend to reorganize it through the Circuit Court, Mr. Sims? A. I don't know; I am not a lawyer, Judge. I had hoped to work out a plan and submit it by mail to the contract holders.

Q. What sort of plan had you hoped to work out? A. Well, that was very thin and nebulous.

Q. Suppose you give it to us, however thin and nebulous it may be. A. I thought the company could be mutualized and turned over to the contract holders, give the stock to the contract holders; it ought to belong to them because there is nothing left there for the stockholders.

* * * * * *

ISAIAH SMITH.

(R. 480):

Q. Do you think it could be done? A. My personal thought?

Q. Yes. A. Without attempting to qualify as an expert, and without attempting to say what sort of plan, in my opinion with the assets the size that Fidelity has, a reorganization of some sort can be done.

* * * * * *

(R. 481-482):

Q. Now, with reference to reorganization, I think I copied your words down when you said you believed reorganization of some sort can be done. Is that substantially what you said? A. Yes, that is a pretty broad term, I expect.

Q. Now, you have had some two months' experience as a state court receiver, and have had approximately the same time as an employee of the trustee in this proceeding, is that not right? A. Yes.

Q. As such you have had some little chance to study the working of Fidelity although your main employment

has been in trying to gather the various funds together and to get reports up on them. A. That is right.

Q Now, when you say reorganization of some sort can be done, you are using that purposely in a very broad sense, are you not? A. I am.

Q. You are not attempting to state you believe there can be 66⅔% of the creditors or contract holders, either as a whole or of any one class, who can or will agree to any specific plan, are you? A. Of course, I could not answer that question without knowing something about the plan. I don't know what they are going to do, and even any kind of plan we might finally think is good I don't know who will accept it and who will not.

* * * * * * *

RAYMOND LATTA.

(R. 1105-1106):

The Court: I will sustain that objection in that form. I will ask the witness this question, however, which I think will cover the situation, as I see it.

Q. Mr. Latta, is it possible to construct an actuarial plan of reorganization for Fidelity? A. Yes.

Mr. Palmer: In your experience, Mr. Latta, would that actuarial plan work?

Mr. Ray: Oh, that is the same thing in another way, trying to get the witness to answer something the Court has ruled he is not qualified to answer.

The Court: Sustained.

Mr. Palmer: I will have to make an offer upon the record, your Honor.

The Court: All right.

Mr. Palmer: The witness, if permitted to answer the question, would state that it is unreasonable to expect a plan of reorganization can be effected for Fidelity. The witness would further say, if permitted by the Court so to testify, that Fidelity itself can never be reorganized as

a going concern, either as a face amount certificate company or as a life insurance company. If the Court would permit, I would like the witness to be permitted to state his reasons why Fidelity can never be reorganized and operated as a face amount certificate company and as a life insurance company, those reasons being based upon his experience and actuarial knowledge. I ask the Court's permission for that.

* * * * * *

(R. 1110-1111):

Q. Mr. Latta, will you please explain your answer to the Court's question when he asked you if Fidelity could be reorganized actuarially—I don't know the exact question, but you answered the Court's question "Yes". Would you explain your answer, please? A. Actuarially whether it could be reorganized strictly from a mathematical viewpoint, as I interpreted his question to be, would be as to whether there could be computed, as far as figures are concerned, in order to place this company in a solvent condition, ready for operation on a sound financial basis as of that time. That is my interpretation of what he meant.

Q. Would it be possible to answer the Court's question by saying, "We will take from each contract holder forty per cent or place a forty per cent lien upon each contract holder," work that out actuarially, and then you would have the company reconstructed actuarially upon a sound basis? Would that be possible?

Mr. Huwe: I object to that question.

The Court: Overruled.

A. It would make the company solvent, but it wouldn't be reorganized on a sound basis, no.

Mr. Palmer: Beg your pardon? A. It would be solvent at the time provided the forty per cent was sufficient. You could make the company solvent, but that doesn't make it sound from an operating viewpoint, actuarially or otherwise.

Q. What would you do to do that? A. Well, as far a plan of reorganization was concerned, you would have to make the entire construction of the company so that the future operations could be done on a sound basis—could be carried on on a sound basis. By a sound basis, I mean as far as being able to meet the obligations when they may become due as specified in the contract.

Mr. Palmer: In other words, whether or not you could possibly construct an actuarial plan for Fidelity and your answer to that bears no relation to what your answer would be as to whether Fidelity could be successfully rehabilitated, is that correct? A. They are entirely separate questions.

Q. And bear no relation to each other? A. No.

* * * * * *

HOWARD E. REED,

(R. 736-737):

Q. Mr. Reed, from your business experience in the past and from your knowledge of Fidelity and the character of its business, will you state whether or not, in your opinion, a plan of reorganization of Fidelity can be developed which will be practical and feasible? A. I think it can.

Q. Do you care to make any statement of your reasons for your answer? A. Well, of course my reasons are purely from the sales standpoint. I think that there is a great field in this country for an income contract—an income reserve contract. I don't believe that we have scratched the surface in systematic saving in this country. We are today reputed to be the greatest savings nation in the world, but the per capita savings as of June 30, 1940, were $196. So that there is yet a tremendous field for this business which has not been touched. Mr. Carpenter told me in Cleveland that he had made twenty-five interviews that week and in no instance did any man whom he interviewed mention defense bonds, so that we feel that there is still a great field for this business regardless of any so-called government competition.

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CLERK

IN THE

# Supreme Court of the United States

OCTOBER TERM, 1942

## No. 319

FIDELITY ASSURANCE ASSOCIATION, a corporation, Debtor, and CENTRAL TRUST COMPANY, Trustee for Fidelity Assurance Association,

*Petitioners,*

vs.

EDGAR B. SIMS, Auditor of the State of West Virginia, and Ex Officio Insurance Commissioner of the State of West Virginia; H. ISAIAH SMITH and ROSS B. THOMAS, West Virginia State Court Receivers; BANKING COMMISSION OF WISCONSIN; CHAS. R. FISCHER, Commissioner of Insurance and Permanent Receiver for debtor corporation in and for the State of Iowa; JOHN B. GONTRUM, Insurance Commissioner of the State of Maryland; DEWEY S. GODFREY, Missouri State Court Receiver; L. H. BROOKS, Trustee, FREDERIC LEAKE and A. L. GOLDBERG, JR., Trustee; and SECURITIES AND EXCHANGE COMMISSION,

*Respondents.*

# JOINT BRIEF OF RESPONDENTS EDGAR B. SIMS, AUDITOR AND EX OFFICIO INSURANCE COMMISSIONER OF THE STATE OF WEST VIRGINIA, AND H. ISAIAH SMITH AND ROSS B. THOMAS, WEST VIRGINIA STATE COURT RECEIVERS.

IRA J. PARTLOW,
*Acting Attorney General of West Virginia,*

KOONTZ & KOONTZ,
*Attorneys for West Virginia State Court Receivers.*

J. CAMPBELL PALMER, III,
*Of Attorneys for West Virginia State Court Receivers.*

*Counsel for West Virginia Respondents*

JARRETT PRINTING COMPANY, CHARLESTON, W. VA.

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IN THE

# Supreme Court of the United States

OCTOBER TERM, 1942

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**No. 319**

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FIDELITY ASSURANCE ASSOCIATION,
a corporation, Debtor, and
CENTRAL TRUST COMPANY, Trustee for
Fidelity Assurance Association,

*Petitioners,*

vs.

EDGAR B. SIMS, Auditor, etc., et al.,

*Respondents.*

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## JOINT BRIEF OF RESPONDENTS EDGAR B. SIMS, AUDITOR AND EX OFFICIO INSURANCE COMMISSIONER OF THE STATE OF WEST VIRGINIA, AND H. ISAIAH SMITH AND ROSS B. THOMAS, WEST VIRGINIA STATE COURT RECEIVERS.

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## OPINIONS BELOW

The opinion of the District Court is reported in 42 F. Supp. 973 (S. D. W. Va.) and is contained in the record (R. 176); the unanimous opinion of the Circuit Court of Appeals is reported in 129 F. (2d) 442, and is contained in the record (R. 238).

## JURISDICTION

The jurisdiction of this Court rests upon Section 240(a) of the Judicial Code, as amended by the Act of February 13, 1925, and Section 24(c) of the Bankruptcy Act.

## STATUTES INVOLVED*

### United States Statutes

The following sections of Chapter X of the Bankruptcy Act: Sec. 130(7), 11 U. S. C. A. 530; Sec. 141, 11 U. S. C. A. 541; Sec. 144, 11 U. S. C. A. 544; Sec. 146, 11 U. S. C. A. 546, Parts (3) and (4).

### West Virginia Statutes

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### Constitutional Provisions Involved

Eleventh Amendment to the Constitution of the United States.

## STATEMENT OF THE CASE

### Foreword

The petitioners herein are Fidelity Assurance Association, a West Virginia corporation, hereinafter called the Debtor or Fidelity, and Central Trust Company, of Charleston, West Virginia, called the Trustee. The Securities and Exchange Commission, one of the respondents herein, which seeks reversal of the judgment below, is referred to as the S. E. C.

There are seven respondents in this case† who filed controversial answers to the Debtor's petition in the District Court, and joint and several appeals in the Circuit

*In the Appendix hereto, Parts I and II, are set out the United States and West Virginia statutes and constitutional provisions which are herein involved, or discussed in this brief, except those statutes which have been printed in the Appendix to petitioners' brief, to which reference is made.

†See R. 287-288 for official designation and 42 F. Supp., at 976, for their official representation.

Court of Appeals; five of them will be referred to herein as the Wisconsin, Iowa, Missouri, Maryland and Tennessee respondents.

This brief is filed jointly on behalf of Edgar B. Sims, Auditor and ex officio Insurance Commissioner of the State of West Virginia, and H. Isaiah Smith and Ross B. Thomas, West Virginia State Court Receivers, hereinafter referred to jointly as the West Virginia respondents, and separately, as the Auditor of West Virginia and the West Virginia Receivers or State Court Receivers.

Four briefs will be filed by the respondents, who have divided the legal points among themselves; therefore each brief will not set out all questions in issue, but only those which will be discussed therein; so it will be necessary for the Court, if it will, to consider all briefs filed by the respondents as one composite brief.

In the brief of the Wisconsin respondents will be a full "Statement of the Case"; this and other briefs of respondents will set forth such additional "Statement" as may be necessary to a proper presentation of the points therein argued.†

## How the Case Arose

Fidelity Assurance Association, formerly Fidelity Investment Company, a West Virginia corporation, with its principal office in Wheeling, West Virginia, from 1911 through 1940 sold installment investment annuity contracts, recently called face-amount-certificates. By reason of State laws so requiring, deposits of securities were

†R.____ designates the page of the printed record; Ex. p.____ refers to the original exhibits, which are not printed; Michie's 1937 Code of West Virginia will be designated Code — — —, being respectively, chapter, article and section. *All emphasized places in this brief are by counsel.*

made in fifteen States, in trust with State officials, for the protection of contract holders in each of those States. Fidelity being unable to comply with the provisions of the Investment Company Act of 1940, and having been in financial difficulties for some years, and being unable to obtain new capital, the Attorney General of West Virginia, on behalf of Auditor Edgar B. Sims, on April 11, 1941, instituted statutory proceedings in a West Virginia State Court against Fidelity as an insolvent. Fidelity's assets were then valued at approximately $2,500,000 less than the liabilities (R. 181), and no equity remained for the stockholders (R. 196, 259). Officials in other States having a deposit of Fidelity then instituted similar proceedings in their States. (See Appendix, Part III.) While those proceedings were progressing, some of Fidelity's former officers, on June 6, 1941, instituted Chapter X proceedings in the United States District Court for the Southern District of West Virginia, which approved the petition and appointed a Trustee.

Auditor Sims, officials of other States, and groups of contract holders contested the good faith in the filing of the petition, and the jurisdiction of the District Court. After a lengthy hearing, all questions were decided against them, and an appeal was taken to the United States Circuit Court of Appeals for the Fourth Circuit. The decision of the District Court was reversed and the Debtor's petition was ordered dismissed, the Court holding that Fidelity had become an insurance company before the petition was filed, that the company should be liquidated, and that prior proceedings were pending in the State Courts which would best subserve the interests of the contract holders in such liquidation. Debtor and its Trustee petitioned this Court for a writ of certiorari, which was granted. The facts upon which the arguments made in this brief will be based are stated below.

**Background of State Deposits Made by Fidelity**

The Legislature of West Virginia in 1911 first enacted legislation licensing the selling of annuities in West Virginia by companies other than life insurance companies, after a compliance with certain conditions precedent. Shortly thereafter, Fidelity was incorporated in West Virginia and, after a compliance with the statutory requirements and conditions, obtained a license and engaged in the business of selling installment annuity contracts.

The most important feature of this legislation was the requirement that such a company, as a condition precedent to receiving a license to do business in the State, deposit with the Insurance Commissioner, "in trust, for the benefit of its contract holders in this State," approved securities in the amount of $10,000.00.

This legislation was amended from time to time so that by 1933, when respondent Edgar B. Sims was elected and took office as Auditor of West Virginia, and by statute (Code 33-1-1) became ex officio Insurance Commissioner of West Virginia, the pertinent part of the depository law with regard to annuity companies (Code 33-9-3) required that companies selling installment annuities "deposit with the state treasurer (in accordance with Article 5, Chapter 12 of this Code), in trust, for the benefit of its contract holders," approved securities in the amount of $100,000.00, and in addition thereto an amount equal to its cash liabilities to its contract holders; and when "the laws of any other state" require a deposit "equal or greater in amount for the benefit of contract holders in such state," upon filing a certificate from the proper official of that State with the Insurance Commissioner of West Virginia, no deposit was required in West Virginia for the benefit of contract holders in that State; and "when the laws of another State require such deposit less in amount," then a certificate showing the amount de-

posited must be filed and a deposit is required in West Virginia "which together with the deposit made in such other state shall make up the total amount required by this state to be deposited * * * and such contract holders in such other state shall not be entitled to the benefit of the securities deposited with the treasurer of this State under this article, except so much of such deposit as may be made to complete the total amount required by this article where the law of any other state requires a lesser amount." On January 1, 1941, there was approximately $10,000,000 in securities on deposit with the State of West Virginia for the protection of Fidelity's contract holders, by virtue of this statute.

Statutory deposit requirements were enacted by other States sometimes as a part of their "Blue Sky" laws, and sometimes as special laws to regulate companies of this type (see Ex. 6, pp. 125 and 177, Report of S. E. C. to Congress); and at the institution of these proceedings, in thirty-six States of the United States (see Table B, infra) a deposit was required of either Fidelity or Investors Syndicate, the only other substantial company doing a similar business to that of Fidelity,* and deposits had been made in fourteen of those States by Fidelity.[1] The required deposits were in an amount not less than 100% of cash liability to the contract holders, except in

*Together these two companies did 98% of said business. See Ex. 6, pp. 3, 128-9, Report of S. E. C. to Congress, Appendix, Part VIII.

[1]In Delaware, Illinois, Iowa, Kansas, Maryland, Ohio, Pennsylvania, Tennessee, Virginia and Wisconsin a deposit was required by the statute. In Kansas the requirement for a deposit was not reenacted into their securities laws after 1929. The Ohio deposit law was passed on April 21, 1939, and beginning March 1, 1940, was to be retroactive. The Illinois deposit law was passed July 7, 1931, and at a later date it was made retroactive. In Indiana there was a deposit law prior to April 1, 1935, and there was no depository requirement between that date and April 1, 1939. After that date, Indiana (as did Alabama, Kentucky and Missouri, through their Securities Department) required Fidelity to enter into a trust indenture, with a named trustee, usually a local bank, and to deposit securities under said trust agreement to be equal at all times to not less than 100% of its cash liability to its contract holders in the state.

Pennsylvania and Virginia, where fixed amounts of $100,000.00 and $25,000.00, respectively, were required to be deposited. On January 1, 1941, there was on deposit in these fourteen States approximately $10,000,000.

All such deposit statutes and required trust indentures specifically provided or stated in substance that the required deposit of securities was to be *in trust, for the benefit of contract holders or purchasers* in the particular State requiring such a deposit; most of the deposit laws and all of the trust indentures provided a proceeding for liquidation and distribution in event of insolvency, usually in a State Court, and under the supervision of State officials, advised by their Attorney Generals.[2]

In West Virginia, the supervising authority for Fidelity and its deposit was the Auditor and ex officio Insurance Commissioner, who upon default or insolvency (Code 33-9-10) could revoke the license of the company, and thereupon "the deposit, or a sufficient amount of the same, shall remain under his authority and control" until the total liability of all the contracts is redeemed or settled.

It was further provided (Code 33-2-45) that the Insurance Commissioner, when any company under his supervision became insolvent, could file a bill in the Circuit

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[2]In the Appendix, Part III, is set forth a brief summary of the deposit laws and requirements of each of the fifteen States wherein Fidelity made a deposit, and as well a brief resume of the proceedings pending therein on June 6, 1941, at which time the Chapter X proceedings were instituted; also, a table (Appendix, Part VIII) prepared by the S. E. C. showing the thirty-one States having a deposit of over $48,000,000.00 from Investors Syndicate.

Appendix D of the S. E. C. brief purports to set out in full all the laws and trust indentures of the fifteen depository States. However, it is incomplete, since it leaves out some sections and parts of sections of the State laws and trust indentures, believed by respondents to be pertinent. Briefs of respondents will set out all the applicable laws of their own States, and the summary in Appendix, Part III, hereof attempts to give a correct summary of the laws and indentures of every depository state.

Court of Kanawha County (the seat of the State government) for the administering of the assets of such company as an insolvent, and for the purpose of taking possession of its property in the State and the distribution of its assets among those entitled thereto, according to their respective rights.

Fidelity's contracts contained a provision that the reserve funds were to be invested in approved securities and "deposited in trust in acordance with the laws of West Virginia."

**Institution of State Court Proceedings**

As set out fully in the Wisconsin brief, Fidelity's financial difficulties began at least as early as the depression years, and new capital was sought for Fidelity for several years prior to 1941. None was ever procured, none has since been promised, and there is no pending promise for new capital to be forthcoming in these proceedings.

Fidelity was unable to comply with the requirements of the Investment Company Act of 1940 (passed in August, 1940), and was thereby prohibited from further engaging in the annuity business after January 1, 1941. It failed to procure new capital, and failed in attempted voluntary reorganization plans. On December 31, 1940, it converted itself into an insurance company, but being unable to comply with West Virginia laws to continue in such business, it shortly became apparent that Court proceedings were necessary. On March 25th, Auditor Sims requested the company to advise him of its choice between Federal and State Court proceedings (Ex. 94, set out in Appendix, Part V). On April 4, 1941, all of its licenses having been revoked, Fidelity was ordered by Auditor Sims to freeze all of its accounts and the West

Virginia deposit remained under the authority and control of the Auditor until the total liabilities were redeemed or settled (Code 33-9-10). Thereupon, Fidelity, at a two-day session of its board of directors (April 7th and 8th), resolved and expressed its preference in favor of State Court proceedings (R. 408).

On April 11, 1941, the statutory proceedings authorized to be brought by the Insurance Commissioner (when any company under his supervision becomes insolvent) in the Circuit Court of Kanawha County were instituted by the Attorney General of West Virginia on behalf of the Auditor (R. 61, 82). This Court had full equity jurisdiction (R. 1206), the exercise of which was also prayed for in the bill of complaint (Ex. 21, p. 16). Officials of all other States holding a Fidelity deposit were notified by Auditor Sims by telegraph, and they immediately took proper action and brought proper proceedings under the laws of their States (R. 62).

In the West Virginia proceedings receivers were appointed to collect the *undeposited* assets of the Debtor (Ex. 70), and those receivers are respondents in the case at bar. Fidelity appeared and raised no objection and filed no answer.

The State Court Receivers took charge of the home office of Fidelity, and collected the undeposited assets of Fidelity. In the two months period of their operation, they had prepared most of the financial and other data necessary to a study of the situation.

### Institution of Chapter X Proceedings

On June 3, 1941, a purported corporate meeting of Fidelity was held in Pittsburgh (this meeting later being held by the District Court to have been invalid [R. 189]), at which a resolution was passed, purporting to authorize the filing of a petition under Chapter X.

Pursuant to this purported authority, on June 6, 1941, Debtor's petition was filed in the United States District Court for the Southern District of West Virginia. Immediately thereafter Central Trust Company of Charleston, West Virginia, was appointed as the disinterested trustee and attorneys for it were appointed by the Court (R. 1); a turn-over order was at once entered against all State authorities, and all State Court Receivers, including the respondents in the case at bar and any others who had in their custody, possession or control any assets which had been deposited by Fidelity, or which belonged to it. (R. 2). This order was amplified and strengthened on June 10, 1941 (R. 11). All of these proceedings were *ex parte* and without notice to these respondents (R. 176).

The West Virginia State Court Receivers, under written protest (R. 80), turned over the undeposited assets of Fidelity which they had collected, together with an escrow fund comprising payments made by contract holders after Auditor Sims' freezing of accounts on April 4th.

The Auditor of West Virginia, who had not turned over the West Virginia deposit to the State Court Receivers (such deposit having remained in the custody of the State Treasurer and under the authority and control of the Auditor as required by Code 33-9-10), together with the officials of the other fourteen depository States, refused to comply with the turn-over order. Auditor Sims, through the Attorney General of West Virginia, and the State Court Receivers by their attorneys, applied to the District Court for a stay of the turn-over order; and, upon refusal thereof, made application to the Circuit Court of Appeals for a stay, pending an appeal from the order. Thereafter, by agreement of counsel, the then *status quo* of the deposited securities was continued pending a hearing in the District Court. Auditor Sims and the State Court Receivers intervened in the District Court as par-

ties, by permission of the Court, and filed controversial answers to the Debtor's petition (R. 58, 79) challenging the jurisdiction of the District Court to entertain the Chapter X proceedings, and challenging the good faith in the filing of Debtor's petition, and appealed to the Circuit Court of Appeals from the turn-over order.

While there had been no objections raised by contract holders to the State Court proceedings (R. 483), groups of contract holders from West Virginia, Tennessee, Iowa, Michigan and Ohio appeared in the District Court, by counsel (R. 287-288), and objected to the Chapter X proceedings, and most of them filed controversial answers to the Debtor's petition.

Thereafter, a majority of the States which held a deposit of Fidelity entered an appearance in the District Court on behalf of their proper State officials, represented in most part by their attorney generals, and filed controversial answers to the Debtor's petition (R. 287-288).

The S. E. C. intervened as a party in the proceedings and undertook to sustain the validity thereof and the jurisdiction of the District Court. The Trustee, through its attorneys, took part in the proceedings for the same purpose.

A hearing was had upon the issues raised by the petition and answers from August 5, 1941, intermittently until October 10, 1941.

On August 9, 1941, during the hearing, the turn-over order against the depository States was amended *nunc pro tunc* to June 6th into a "freezing" order which enjoined the officials of the depository States from doing anything with the deposited securities except hold them (R. 102), but the Trustee was not required to return to the West Virginia State Court Receivers the funds they had

turned over to the Trustee. Maryland, Tennessee and West Virginia respondents filed motions to vacate this order (R. 124, 128, 168, 170, 172).

The West Virginia respondents sought a writ of prohibition in the Circuit Court of Appeals against this "freezing" order, which on October 21, 1941, was argued jointly with their appeal from the turn-over order. The principal issue raised by the appeal was whether the Eleventh Amendment to the Constitution of the United States was a bar to taking the deposited assets from the State of West Virginia and causing them to be turned over to the Trustee. The Circuit Court of Appeals, being informed during oral argument, of the hearing currently being held below, and perceiving that later a more complete record would be before it in an appeal upon the merits, and that the rights of other depository States who were not parties to the appeal would of necessity have to be adjudicated, thereupon refused the writ of prohibition and dismissed the appeal without prejudice. *Sims* v. *Central Trust Company*, 123 F. (2d) 89.

## Solvency of Fidelity

While there are many financial statements of Fidelity in evidence, none adequately presents a correct picture of the net assets and net liabilities of Fidelity as of April 10, 1941, its last day in active business. Therefore, counsel has compiled Table A below from original and unprinted Exhibits Nos. 35, 47 and 48.

Exhibit 48 correctly states the liabilities as of April 10, 1941, both net reserve and net cash surrender (that is, after deduction of loans to contract holders). However, the figures given in Ex. 48 for the total at market value as of June 6, 1941, of all securities deposited with the States ($20,056,680.27) and the free securities ($556,467.51), although used by Judge Soper in the opinion be-

low (R. 242), are incorrect. The sum total of those two amounts is exactly the same as shown in Ex. 35 for total value as of June 6, 1941, of all the deposited securities at *market value*, plus the value of all mortgages at *book value*. Therefore, the figures given in Ex. 48 are not market value, but include all the mortgages at book value.

Attached to Ex. 35 is a breakdown of the mortgages into classes. In view of the testimony as to the value of the mortgages and real estate (Original transcript of evidence, pages 1248, 1250-53, 1258-60, 1331-46, and 1353-56, only part of which is in the printed record at R. 612-15 and 619-20), and the statement in S. E. C. Appendix C to brief, page 7s. 2(b), counsel has arbitrarily set the value of the real estate, furniture and fixtures, and all mortgages except F. H. A.'s at 60% of the stated book value.

Exhibit 47 gives the gross assets of Fidelity as of April 10, 1941, hence the necessity for restatement to show only the net assets.

There are other small liabilities, and perhaps other small amounts of assets, but counsel believe Table A presents a reasonably correct and adequate picture of the situation as it then existed.

The deficit of Fidelity on April 10, 1941, was therefore $3,192,666.55, and the percentage of solvency was 86.97% based upon net assets and net reserves.

# TABLE A

## SUMMARY OF ASSETS AND LIABILITIES, APRIL 10, 1941

**Fidelity Assurance Association**

**Condensed from Original Exhibits 35, 47, 48**

### ASSETS[a]

| | | |
|---|---|---|
| Market value of all securities | | $19,075,549.58 |
| Cash | | 570,245.73 |
| Accrued interest on Bonds, Mortgages, etc. | | 322,466.46 |
| Miscellaneous | | 19,598.35 |
| Net value life insurance | | 2,994.24 |
| Mortgages, F. H. A. | | 592,594.95 |
| | *(Book Value)* | |
| Real Estate | ($438,105.11) | [b]262,863.07 |
| Mortgages, Home Office Building | ( 450,000.00) | [b]270,000.00 |
| Mortgages, Other Real Estate | ( 256,500.00) | [b]153,900.00 |
| Furniture and Fixtures | ( 80,648.34) | [b]48,389.00 |
| Total | | $21,318,601.38 |

(a) All figures are from Ex. 47, except the breakdown of mortgages is attached to Ex. 35.

(b) Arbitrarily stated at 60% of book value, in view of testimony and Court's comments thereon, R. 612 to 615 and 619-620; also statement in Appendix C to S. E. C. brief, p. 7s. 2(b). Total amount thereby deducted $457,842.04.

**LIABILITIES—NET RESERVE BASIS**

| | |
|---|---|
| Net Reserve Liability to Contract Holders | [c]$24,221,651.37 |
| Net Deficiency U. S. Income Tax Claim | [d]289,616.56 |
| Total | $24,511,267.93 |

**DEFICIT—NET RESERVE BASIS**

| | |
|---|---|
| Total | $ 3,192,666.55 |

**PER CENT OF SOLVENCY**

| | |
|---|---|
| Per cent of solvency net reserve basis | 86.97% |

[c] Ex. 48.
[d] As of May 27, 1941 (R. 1221).

## Liquidity of Deposited Securities

On pages 96 and [illegible] of Exhibit 6, the report made to Congress by the S. E. C. concerning Fidelity, it is stated: "The Association has followed a settled policy of investing its funds almost entirely in marketable securities, about 90% of which have consisted of bonds and notes. Investments in stock have consisted principally of preferred stocks and have been, in the main, too small to be of any importance." On the same pages, as set forth in the Appendix, Part VIII herein, is Table 26, showing the percentage by years of investments by Fidelity in various categories. The percentage of investment in real estate, as shown by the table, has always been less than 1% of the assets.

In a letter to the contract holders dated July 3, 1941, the Trustee herein stated that Fidelity's property "is almost entirely in the form of liquid assets composed of stocks, bonds and other forms of securities" (R. 45).

At the present time, Fidelity is even more liquid, as many securities, some real estate, and some mortgages, have been converted to cash.

## Specific Data on Contract Holders and Deposits

The numerous exhibits introduced in evidence, which contain voluminous detailed financial data, are not printed in the record herein, but are before the Court in their original form. Counsel have taken the liberty of transposing and shortening much that is therein contained into the following tables, with accompanying explanations.

A composite picture of the location of the contract holders by States, showing the net reserve and net cash liability due them, and the location of the deposited securities, together with their market value, and the per-

centage of market value to cash liability, is set out hereunder in Table B.[a]

Fidelity listed the contract holders on its books by States, according to their residence, such information being furnished by the contract holder. Deposits in the States were made, changed, substituted and withdrawn accordingly, as the contract holder gave his residence or change of residence (R. 758, 759). Therefore the statement in Appendix A, p. 2, footnote, S. E. C. brief, is not correct. For that reason, the table is in the form below.

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[a]This table is compiled principally from unprinted Ex. No. 34 and No. 48, and the market value of securities contains mortgages at book value as heretofore explained. See also Appendix, Part IX.

# TABLE B
## Fidelity Assurance Association

| 1 | State 2 | No. of Contracts having reserve value or monthly payments being paid currently on 4/4/41 3 | Total No. of Contracts 4 | Net Reserve Liability April 10, 1941 5 | Net Cash Liability April 10, 1941 6 | Securities Deposited Market Value June 6, 1941 7 | Percentage of Market Value to Cash Liability 8 |
|---|---|---|---|---|---|---|---|
| FD | Alabama | 81 | 172 | $ 32,267.31 | $ 31,346.71 | $ 32,555.16 | 103% |
| | Arizona | 24 | 22 | 10,613.46 | 10,191.92 | | |
| | Arkansas | 16 | 18 | 8,629.80 | 8,221.58 | | |
| D | California | 228 | 236 | 174,940.15 | 169,577.35 | | |
| D | Colorado | 25 | 30 | 18,576.99 | 17,909.03 | | |
| D | Connecticut | 175 | 255 | 119,650.18 | 116,276.09 | | |
| | District of Columbia | 1,658 | 2,644 | 982,833.44 | 952,502.25 | | |
| FD | Delaware | 582 | 875 | 300,074.88 | 290,175.36 | 293,790.63 | 101% |
| D | Florida | 119 | 154 | 100,987.41 | 97,946.02 | | |
| D | Georgia | 254 | 508 | 163,021.69 | 159,164.28 | | |
| | Idaho | 2 | 1 | 1,287.11 | 1,263.00 | | |
| FD | *Illinois | 8,051 | 12,209 | 4,368,348.52 | 4,225,790.75 | 3,759,894.00 | 89% |
| FD | **Indiana | 846 | 1,293 | 398,336.17 | 386,173.45 | 162,863.44 | 42% |
| FD | Iowa | 54 | 84 | 35,332.03 | 34,478.27 | 45,082.50 | 130% |
| FD | Kansas | 254 | 405 | 111,530.90 | 108,784.89 | 85,337.50 | 76% |
| FD | Kentucky | 328 | 662 | 95,376.98 | 92,690.42 | 86,712.50 | 93% |
| D | Louisiana | 301 | 375 | 42,934.29 | 40,941.77 | | |
| | Maine | 6 | 5 | 2,577.16 | 2,484.50 | | |
| FD | Maryland | 1,152 | 2,080 | 508,163.70 | 492,552.24 | 470,806.25 | 95% |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| | Montana | 4 | 7 | 5,166.49 | 5,111.50 | | |
| D | Nebraska | 24 | 20 | 7,882.08 | 7,661.27 | | |
| D | Nevada | 1 | 3 | 317.95 | 312.50 | | |
| D | New Hampshire | 9 | 12 | 9,312.83 | 9,151.84 | | |
| D | New Jersey | 536 | 777 | 294,381.20 | 285,356.15 | | |
| | New Mexico | 11 | 11 | 9,686.28 | 9,371.06 | | |
| D | New York | 1,049 | 1,456 | 690,448.27 | 669,824.67 | | |
| D | North Carolina | 117 | 183 | 82,995.68 | 80,592.13 | | |
| D | North Dakota | 9 | 10 | 37,394.11 | 36,487.35 | | |
| FD | Ohio | 6,059 | 14,807 | 2,439,364.17 | 2,360,418.70 | 509,573.44 | 21% |
| | Oklahoma | 97 | 148 | 108,793.10 | 105,815.64 | | |
| D | Oregon | 8 | 11 | 4,323.01 | 4,137.24 | | |
| FD | Pennsylvania | 8,794 | 14,663 | 4,816,175.07 | 4,668,582.25 | 232,591.57 | 5% |
| | Rhode Island | 10 | 14 | 6,822.86 | 6,647.71 | | |
| | South Carolina | 256 | 351 | 42,152.14 | 41,130.62 | | |
| D | South Dakota | 11 | 11 | 6,869.07 | 6,785.12 | | |
| FD | Tennessee | 557 | 1,188 | 206,879.70 | 200,504.97 | 196,574.38 | 98% |
| D | Texas | 89 | 84 | 39,152.19 | 37,829.08 | | |
| D | Utah | 3 | 3 | 2,020.48 | 1,944.00 | | |
| | Vermont | 6 | 9 | 3,723.17 | 3,564.50 | | |
| FD | Virginia | 1,406 | 2,443 | 572,585.26 | 557,809.12 | 27,703.13 | 5% |
| D | Washington | 41 | 41 | 35,646.49 | 34,650.60 | | |
| FD | West Virginia | 4,947 | 8,260 | 2,256,147.34 | 2,181,681.75 | 10,674,696.08 | 489% |
| FD | Wisconsin | 6,595 | 12,112 | 2,408,301.57 | 2,342,978.73 | 2,619,399.07 | 111% |
| D | Wyoming | 6 | 8 | 5,783.00 | 5,679.79 | | |
| | Foreign Countries | 107 | 116 | 74,982.34 | 72,811.33 | | |
| | TOTAL ALL STATES | 50,201 | 87,999 | 24,221,651.36 | 23,475,668.67 | 120,056,680.26 | 85.4% |
| | *Illinois, issued before 7/7/31 | 1,820 | 3,219 | 983,117.48 | 927,051.05 | | |
| | *Illinois, issued after 7/7/31 | 6,231 | 8,990 | 3,385,171.04 | 3,298,739.70 | | |
| | **Indiana, issued before 4/1/35 | 200 | 614 | 116,615.51 | 111,974.93 | | |
| | **Indiana, issued between 4/1/35 and 4/1/39 | 446 | 679 | 263,298.69 | 256,326.23 | | |
| | **Indiana, issued after 4/1/39 | 200 | 200 | 18,421.97 | 17,872.29 | | |

†—Includes mortgages at book value as explained for table A.

## Explanation of Table B

In column 1, the "D" indicates a State with a depository law and which holds deposits of Fidelity or Investors Syndicate, the "FD" indicating Fidelity deposits.

Column 4 gives the total number of contracts, including those with no cash surrender or reserve value, but having a re-date privilege.*

Column 3 includes contracts upon which payments were currently being made, but an aggregate amount had not been paid sufficient to create, in some cases a reserve value, and in other cases a cash surrender value. It lists only the number of contracts and not contract holders, some of whom owned more than one.

Mr. McNulty, Secretary of the Debtor (R. 407), testified there were 22,000 to 25,000 actively paying contract holders on April 4, 1941 (R. 407). In addition, there were some fully paid-up contracts and some matured contracts.

Therefore, the number of contract holders financially interested varies between 22,000 minimum and 50,000 maximum.

In column 5 and 6 the net reserve and net cash liability is shown, which are those values after deducting the loans and accrued interest thereon.

The peculiarities of the Illinois and Indiana depository statutes are set forth in the Appendix, Part III, and the reason for the divisions of their deposits made in the foot-note.

## Table C

This table is a summary of an arrangement into appropriate groups of the States and figures shown in Table B, with percentages calculated.

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*The re-date privilege is one whereby the contract may be given a new issuance date after it falls into arrears, with prior payments credited on the new certificate. The privilege is, practically speaking, perpetual. (Ex. 6, p. 110).

## TABLE C
### Break-down of Table B into Groups and Percentages
### Summary for All States

| STATES* | No. | No. of Contracts having reserve or monthly payments being paid currently on 4/6/41 | Percent of Total | Net Cash Liability April 10, 1941 | Percent of Total | Market Value Securities Deposited June 6, 1941 | Percent of Total | Percentage of Market Value to Cash Liability |
|---|---|---|---|---|---|---|---|---|
| Non-Depository | | | | | | | | |
| Less than 100 Contracts | 22 | 521 | 1% | $ 404,145.01 | 1.7% | | | |
| Between 100 & 500 Contracts | 9 | 1,841 | 3.6% | 955,276.73 | 4.1% | | | |
| Over 500 Contracts | 4 | 6,401 | 12.9% | 3,355,290.39 | 14.3% | | | |
| Total Non-Depository | 35 | 8,763 | 17.5% | 4,714,712.13 | 20.1% | | | |
| West Virginia | | 4,947 | 9.8% | | | 10,674,696.08 | 53.22% | 489% |
| Total Looking Primarily to West Virginia Deposit | 36 | 13,710 | 27.3% | 6,896,393.88 | 29.4% | $10,674,696.08 | 53.22% | |
| Total Probable Claim Over Against W. Va. Deposit | 5 | 17,359 | 34.4% | 8,081,768.48 | 34.4% | 1,016,069.08 | 5.1% | 12.6% |
| Total Claim Against W. Va. Deposit | 41 | 31,069 | 61.7% | 14,978,162.36 | 63.8% | 11,690,765.16 | 58.3% | 78% |
| Total Probably No Claim Against W. Va. Fund | 9 | 19,132 | 38.3% | 8,497,506.31 | 36.2% | 8,365,915.11 | 41.7% | 98.5% |
| TOTAL ALL STATES | 50 | 50,201 | 100% | 23,475,668.67 | | 20,056,680.27 | 100% | 85.436% |

*A further break-down of this summary into the individual States in each group is in the Appendix Part IX. The District of Columbia and Foreign Countries are each designated as a State.

## QUESTION PRESENTED

The issue discussed in this brief is whether a corporation which sold installment annuity contracts pursuant to State laws especially enacted to regulate such corporations, and whose only substantial assets are securities deposited (as required by those State laws) with States or State officials *in trust* for the purchasers in each such State, and whose liabilities to its contract holders exceed its total assets, including such statutory deposits, may force State officials charged under such State laws with possession, administration, and in the event of insolvency, liquidation and distribution of the proceeds, of such deposited securities, into proceedings under Chapter X of the Bankruptcy Act, when there are then pending prior statutory and general equity State proceedings, instituted by those State officials, which are designed to safeguard and protect the rights of contract holders; and in such Chapter X proceedings take possession and control of the deposited securities from these States or State officials, and nullify or set aside the trust liens of the contract holders, created by the State statutes.

## SUMMARY OF ARGUMENT

Briefs of other respondents will discuss and argue the question of whether Fidelity was an insurance company; whether it can or should be rehabilitated as an annuity or "face-amount certificate" company, or in any other line of business; if liquidation must ensue, whether a slow and orderly one is a reorganization within the purview of Chapter X; and whether there was good faith as defined in Section 146(3) of Chapter X in the filing of the petition. These issues will not be discussed hereinunder, except incidentally.

The West Virginia respondents will endeavor to show the Court that the Debtor's petition was not filed in good

faith as defined in Section 146(4) of Chapter X, in that there were then pending in State Courts, particularly in the Circuit Court of Kanawha County, West Virginia, prior proceedings which would best subserve the interests of Fidelity's contract holders, its only creditors.

In arguing this issue, these respondents will contend that the case at bar is governed by the decision of this Court in the *Marine Harbor* case; that Congress evinced and expressed the intention that in the event of insolvency the deposits should remain with and be administered by the State officials with whom those deposits were made; that there is no necessity for intervention by the S. E. C., and a lack of Congressional direction that it should intervene other than in the limited manner provided by Congress; that the deposits should not be taken from the possession of the State officials, and the trust liens created by the State depository laws, in favor of the contract holders in each State, should neither be nullified nor set aside; that the deposits were made with sovereign States or State officials who, because of the Eleventh Amendment, are not subject to suit, order or injunction by the District Court; that the deposit laws of each State must be interpreted by the State Courts thereof, which are better fitted so to do than is the Federal District Court to do it for them; and that these State officials represented by their Attorney Generals, and acting under the guidance of their respective State Courts, have not been shown not to be as able as the Federal Trustee to liquidate the deposits, and properly to distribute the proceeds thereof.

These respondents in this brief will argue fully one point, and will raise but not argue other points, which were issues raised in the District Court (R. 186-187) and in the Circuit Court of Appeals below, but were not discussed or decided in the opinion below. However, it is believed that this is permissible, and that any ground raised below,

which will tend to sustain, not overthrow, the judgment below, may be herein urged in support thereof.[5]

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[5] *Langnes* v. *Green*, 282 U. S. 531, at 535, 75 L. Ed 520;
*Story Parchment Co.* v. *Patterson Parchment Paper Co.*, 282 U. S. 555, 75 L. Ed. 534;
*LeTulle* v. *Scofield*, 308 U. S. 415, 84 L. Ed. 355;
*Ryeman* v. *U. S.*, 312 U. S. 405, 85 L. Ed. 917;
*Public Service Commission of Puerto Rico* v. *Havemeyer*, 290 U. S. 506, 80 L. Ed. 357.

## ARGUMENT

### I

### THE DEBTOR'S PETITION SHOULD BE DISMISSED BECAUSE IT WAS NOT FILED IN GOOD FAITH AS DEFINED IN SECTION 130 (7) AND SECTION 146(4) OF CHAPTER X OF THE BANKRUPTCY ACT, IT NOT BEING SHOWN THAT THE PRIOR PROCEEDINGS PENDING IN STATE COURTS, PARTICULARLY IN THE CIRCUIT COURT OF KANAWHA COUNTY, WEST VIRGINIA, WOULD NOT BEST SUBSERVE THE INTERESTS OF CONTRACT HOLDERS; SUCH PRIOR PROCEEDINGS HAVING BEEN INSTITUTED IN STATE COURTS BY OR ON BEHALF OF STATE AUTHORITIES HOLDING AS TRUSTEES SECURITIES DEPOSITED BY FIDELITY; PURSUANT TO VALID AND APPLICABLE STATE LAWS, FOR THE BENEFIT OF ITS CONTRACT HOLDERS IN EACH SUCH STATE.

#### A

**The case at bar is governed by the decision of this Court in the Marine Harbor Case, and the rules of law therein decided should be applied herein.**

In the case of *Marine Harbor Properties, Inc.*, v. *Manufacturer's Trust Company*, decided November 9, 1942, 11 U. S. Law Week 4020, 87 L. Ed. (Adv.) 73, Debtor's sole asset was a building located in New York, the value of which was admittedly less than the first mortgage on it. There were also junior mortgages, as well as unsecured debts. The mortgage had been purchased by a mortgage guaranty company, and participating certificates sold to

the public, and later the guaranty company became insolvent. Special New York legislation, called the Shackno Act, was enacted to deal with such insolvencies, and under that Act a trustee had been appointed and was acting in State Court proceedings. Four months after the trustee instituted a foreclosure action for the benefit of the first mortgage holders, the debtor instituted Chapter X proceedings.

The question in issue in the *Marine Harbor* case is the same as that with which we are here concerned, namely, should the Debtor's petition under Chapter X be dismissed under Section 130(7) and Section 146(4) because of prior proceedings pending in State Court?

In the *Marine Harbor* case the property involved was real estate; in the instant case the property is securities. In the former case a mortgage was placed on the real estate and the general public, by reason of having purchased certificates of participation, became the equitable owners thereof; and in the instant case, by virtue of the contract entered into with the purchasers of its contracts, the Debtor contracted to deposit reserve funds "in trust in accordance with the law of the State of West Virginia." (See Statement and Appendix, Part I.) Fourteen other States, by statute or trust indenture, required a similar deposit to be made in each such State, also in trust for the benefit of contract owners or purchasers in each such State.

In both cases the debtor had been in financial difficulties for a number of years; in the instant case at least since 1932. In both cases the debtor had unsuccessfully tried every logical and legitimate way of getting out of its financial difficulties, particularly by obtaining new capital. In the instant case the evidence shows that the Debtor for more than three years scoured the financial centers of the country in an attempt to interest new capital in the

enterprise, wholly without success. In the *Marine Harbor* case there was an intimation of possible new capital to be forthcoming upon reorganization; in the instant case there is positive evidence that there can be and will be no new capital available from any source (R. 260).

In both instances the value of the property is less than the liens upon it. In the *Marine Harbor* case it was less than the first lien; in the instant case there is only one lien, that is a trust lien for the benefit of contract holders, and upon a reserve liability basis (Table A in Statement) the company is only 86.97% solvent.

In both instances State legislation was especially enacted to deal with the particular circumstances. (Ex. 6, S. E. C. Report to Congress, pp. 125 and 127.) In New York the Shackno Act and other co-related legislation was passed to deal with insolvent mortgage guaranty companies. In West Virginia and other States, securities laws were enacted regulating companies selling annuities on the installment plan, requiring deposits from them, and providing proceedings for liquidation upon insolvency. (See Summary in Appendix, Part III.)

In the *Marine Harbor* case, because the value of the property was less than the first lien thereon, there was a necessity of dealing only with those first lienors, under the absolute priorities doctrine of *Northern Pacific R. Co.* v. *Boyd*, 228 U. S. 482, 57 L. Ed. 931, and *Case* v. *Los Angeles Lumber Products Co.*, 308 U. S. 106, 84 L. Ed. 110. In the instant case only the contract holders, all of whom are trust beneficiaries or secured creditors, need be dealt with, because the evidence discloses conclusively (R. 181), and both the District Court and Circuit Court of Appeals have so held, that there is no equity remaining in the assets for the stockholders (R. 196, 259), and it is admitted by petitioners herein (Brief, p. 40).

In both cases, before application was made to the Federal Courts there had been other proceedings. In the *Marine Harbor* case there were voluntary efforts at adjustment between the trustee of the mortgage and the debtor; there were Shackno Act proceedings in which the debtor took part; and then a mortgage foreclosure proceeding, which would have wiped out the debtor's entire interests, and those of the junior lienors.

In the case at bar, Fidelity tried all possible voluntary means of rehabilitation, including attempts to obtain new capital, *and finally* a conversion into a life insurance company. The S. E. C. had thoroughly investigated it and had presented its findings in a printed document to Congress (Ex. 6), and Congress had enacted the Investment Company Act of 1940 for the future regulation of such companies, and Fidelity was unable to continue in the annuity business under that Act.

As set out in the Statement, on April 4, 1941, the Auditor revoked Fidelity's license, retained the deposited securities (Code 33-9-10), and on April 11, 1941, caused his statutory suit to be instituted by the Attorney General in the State Court provided by statute (33-2-45).

The other depository States, by their proper officials, instituted proper proceedings under their laws.

All of these proceedings progressed satisfactorily, and apparently met with the approval of the contract holders, for at least there was no substantial objection thereto (R. 483), until a dissatisfied group of officers and stockholders of the company, held a purported corporate meeting on June 3, 1941, in Pittsburgh (held invalid by the District Court [R. 189]), and authorized the institution of the instant proceedings, for the apparent purpose of obtaining some equity or benefit for themselves, although as stockholders they had no equity remaining. (R. 196, 259).

Again the similarity to the *Marine Harbor* case is noted, in that those who there initiated the proceedings under Chapter X in debtor's behalf, apparently so did hoping to obtain some benefits thereby.

After the proceedings herein were instituted under Chapter X, the various State officials who were trustees of the deposited funds for the benefit of contract holders intervened and objected to the Chapter X proceedings, as well as groups of contract holders from West Virginia, Tennessee, Iowa, Missouri and Ohio (R. 287, 288).

After the affairs of the company had been fully aired by the hearing in the Chapter X proceedings, and it was judicially determined that the Debtor was insolvent in the bankruptcy sense, it was entirely apparent that the company could not be rehabilitated, and the need for prompt liquidation was seen (R. 259). This is apparently admitted by the S. E. C. brief filed herein (Brief, p. 47).

These respondents contend that liquidation should *promptly* ensue and the prior pending State Court proceedings are proper and adequate therefor.

The decision of the *Marine Harbor* case is exactly applicable to the situation here. There is positive evidence that the company is insolvent in the bankruptcy sense. There is entire lack of evidence that any new capital can be produced. It is admitted that the stockholders have no remaining interest or equity (Petitioners' Brief, p. 40). There are no junior interests in this case. Nothing remains under the "full priority rule of the *Boyd* case" but permitting the contract holders to realize upon their security.

Again like the *Marine Harbor* case, "much emphasis is placed on numerous safeguards contained in Chapter X." Again it can be said that these considerations might be relevant and persuasive "if this was the case of the usual

reorganization proceeding dealing with more than one class of securities under the older procedures which Chapter X was designed to improve and supplant"; or those safeguards might be given some consideration if the desired result was rehabilitation instead of liquidation.

However, there is only one class of creditors, that is the contract holders (*in re Stoddard*, 242 N. Y. 148, 151 N. E. 159), each and every one of whom, under the West Virginia law and the laws of the other fourteen depository States, is not only a secured creditor, but a *cestui que trust* or beneficial owner of the securities deposited in trust with the State of West Virginia or with the State in which that contract owner resides.

Therefore, in the case at bar, as in the *Marine Harbor* case, there is no need to determine whether the salutary safeguards of Chapter X exist in the pending State Court proceedings. Particularly is this true since liquidation and distribution are the only actions herein sought, or contemplated.

We request the Court particularly to note that no contract holder in any State, who must look primarily to the West Virginia deposit for his protection, has instituted any action in any State, or has made any objection or taken any Court action, in either his own State or within the State of West Virginia, to the proceedings carried on in the West Virginia Courts and by the Auditor of West Virginia; nor have the officials of any such States.

Mr. McNulty, Secretary of Fidelity, testified however, that forty to fifty per cent. of the contract holders who wrote to the West Virginia Receivers shortly after their appointment, even at that early stage, wanted cash immediately; that is, they desired an immediate liquidation and return of such money as was due them. (R. 320, 330).

After the Federal proceedings were instituted, the evidence shows that a mass meeting of contract holders was held in the City of Wheeling, West Virginia, where the home office of the company is located, and where naturally a large number of its contracts were sold; that the purpose of this mass meeting was to take proper steps to object to the proceedings instituted in the United States Court for the Southern District of West Virginia, and to demand that liquidation promptly ensue (R. 398, 402, Ex. B, C).

The proceedings instituted in the various States with reference to the securities deposited there, are in purpose and effect a foreclosure proceedure upon those deposits, and in nearly every instance are actually liquidation proceedings; and in each depository State there is ample legal machinery, either set up in the depository law, the securities law, or the general or equity law, whereby the securities deposited with the States can be therein liquidated and proper distribution made of the funds to those rightfully entitled thereto. As shown in Appendix Part III, by virtue of either the State statute, or by action in the proceedings, and before institution of the Chapter X proceedings, the legal title to the deposited securities, had become vested in the State or State official acting as trustee for the benefit of the contract holders in Alabama, Maryland, Iowa, Wisconsin and West Virginia.

Again the similarity to the *Marine Harbor* case is noted, because in that case there remained nothing for the trustee in State Court to do but sell the security and distribute the proceeds thereof, which could be done in the State Court in which the matter was pending, and proceedings for which had been started. In our instant case the same situation exists.

In the *Marine Harbor* case this Court held:

> "In view of the burden on a petitioner to make the showing required by Section 130(7) and Section 146(4), the Bankruptcy Court is not warranted in assuming, without more, that a State foreclosure proceeding instituted for and on behalf of the first mortgage creditors exclusively is inadequate, measured by Chapter X standards, to protect their interests. The contrary course would result in Chapter X making greater inroads on prior proceedings than Section 130(7) and Section 146 (4) indicate was the purpose."

Those words are directly applicable to the case at bar, particularly since the affirmance of the decision of the Court below is requested not only by the State officials, respondents herein, who are acting as trustees for the contract holders, but also by officials of other States wherein a deposit was made for the benefit of contract holders, who are acting as trustees in behalf of the contract holders of their respective States. These State officials are not respondents herein, but in a brief *amici curiae* adopted the position of these respondents and requested the same relief.

This Court specifically held: "Every petition under Chapter X must state, *inter alia*, 'the specific facts showing the need for relief under this chapter.' Section 130(7)," and further, "Congress in effect directed the bankruptcy courts not to approve petitions under Ch. X in such cases unless it appeared that the interest of creditors and stockholders would not be best subserved in the prior proceedings. And it put the burden on the petitioner to make that showing." An examination of the Debtor's petition shows that in paragraph III the Debtor stated that it engaged in the annuity business until December 31, 1940, when the Investment Company

Act of 1940 went into operation, "which Act so increased the reserve requirements on the part of Debtor to contract holders that Debtor found it impossible to comply with the provisions of said Act," (R. 5).

The Debtor neglected to state that the Investment Company Act (Sec. 28[a] [1]) provides that each such company must have a clear capital of fifty thousand dollars if organized and continuously operated prior to March 15, 1940, and a capital stock paid in cash of $250,000 if organized after that date, with which provision Fidelity could never comply; because in Section V of its petition it sets out its reserve liability at approximately twenty-five million dollars and its assets at "approximately twenty-three million dollars." (R. 6).

The petition states, in paragraph VII, "by reason of said interest requirements under its said contracts the Debtor is now suffering an annual loss of approximately two hundred and fifty thousand dollars per annum, and that this loss will continue, and probably increase" (R. 7). Debtor further neglected to set forth in its petition that its operating expenses were 25.2% of each dollar of contract holders' money received, of which 18.9% was for selling costs alone (Ex. 6, p. 88, Report by S. E. C. to Congress), and that under the Investment Company Act of 1940 it was restricted to a loading charge of 7% total.

In view of the *Marine Harbor* decision and the language above quoted, we believe this Court will find particularly relevant the reasons Debtor stated in paragraph VII of its petition as showing the need for relief under Chapter X (R. 7).

> "• • • Debtor has been unable to meet its obligations as they mature and will be unable to meet its obligations as they mature, *unless the rights of*

*its contract holders are modified* so that the earnings received on securities and assets owned by Debtor will be sufficient in amount to meet the requirements under its outstanding contracts; and *if the rights of its outstanding contract holders are modified to this extent, Debtor will be able to meet its reserve requirements* and be able to comply with the Investment Company Act of 1940, and will be able to resume the operation of its business.

"* * * and that *the rights of all contract holders must be modified* as above set forth in order that Debtor may be permitted to obtain adequate relief * * *."

In substance, the Debtor, who had no equities of its own as set forth by its own petition, states openly in its petition that the rights of the secured creditors, that is the contract holders, *must be modified*, and not only must they be modified so that the Debtor can continue business and procure the increased reserves required under the Act, but modified so as to procure the capital required by the Debtor to do business under the Investment Company Act of 1940; as there is no statement or intimation that any new capital would be forthcoming.

Therefore, it is submitted that the Debtor has failed to sustain the burden of proof of showing (as required by Sec. 130[7] and Sec. 146[4] of the Bankruptcy Act) that the Chapter X proceedings will better subserve the interests of the contract holders than the prior proceedings pending in the State Courts, particularly that in the Circuit Court of Kanawha County, West Virginia.

B

**Congress in enacting the Investment Company Act of 1940, intended that deposits made with State officials by face-amount certificate companies prior to January 1, 1941, should in the event of insolvency be retained by them, and the trust liens created by State statute should not be set aside; and Congress recognized the validity of, and legislated concerning, insolvency proceedings of such companies when instituted in proceedings other than under Chapter X, and permitted a very limited and strictly defined intervention therein by the S. E. C.**

**Intent of Congress as Expressed in Committee Hearings on Act**

The Investment Company Act of 1940 was enacted as HR-10065 and was introduced in the Senate as S-4108, a substitute for S-3580. As set forth in the report of the Senate Committee on Banking and Currency accompanying S-4108 (Report No. 1775), the original bill was the outgrowth of extensive study of investment trusts and investment companies, conducted by the S. E. C. at the direction of Congress. In the original draft of the Act (S-3580) there was no provision for deposits with States or State officials, and in Section 29 relating to bankruptcy of face-amount certificate companies, it provided that every deposit made with a State agency for the benefit of the holder of any security sold on or after October 1, 1940, should be null and void as against the trustee in bankruptcy of the company. It left unaffected the status of deposits for the benefit of holders of securities sold prior to October 1, 1940.

The bill was explained to the Sub-Committee by Commissioner Healy and Mr. David Schenker, Chief Counsel for the S. E. C. Investment Trust study. He was talking about the provisions therein contained which after amend-

ment became Section 29 of the Investment Company Act, entitled "Bankruptcy of Face-Amount Certificate Companies." With respect to the deposits already made with the States as required by State laws, Mr. Schenker stated:

> "We do not disturb the present deposits and the situation with respect to future payments made on outstanding contracts."
>
> Hearings before Sub-Committee of the Committee on Banking and Currency, United States Senate, Part I, p. 302.

Under questioning by Senator Herring (Iowa) concerning these State deposits, Mr. Schenker stated that they could not unequivocally say "that such security, in the event the company were bankrupt, would be applicable to the certificate holder in the States which required security. There were certain Supreme Court cases which seemed to cast some doubt upon that fact."

> "Senator Herring. Well, we have possession of them and I would like to see them get them.
>
> "Mr. Schenker. Yes; of course you have possession of them. *We used meticulous care to see that those States which have them can hold on to them.* With respect to payments made on certificates already sold, you can keep those, too; but with respect to the future we provide differently.
>
> "Senator Herring. • • • you cannot assume that the Federal authorities are any more competent than the State authorities. If you say that, then you may want to send everything down here to Washington.
>
> "Mr. Schenker. We are not unmindful of that, and we are not disparaging present deposits.
>
> • • • • •
>
> "Mr. Healy. • • • Now, as Mr. Schenker points

out, *the existing status is not disturbed so far as the deposits are concerned.*"

(Pages 310-311, 312.)

The hearings ended after four weeks and resumed on May 31, 1940, at which time there had been a redraft of the bill. In Part IV of that hearing, pages 1124-1125, when Commissioner Healy and Mr. Schenker explained the matter to the Committee, Senator Herring stated:

> "You see our position. We are protecting our face-amount policyholders and are taking care of them, and *we are not going to give up that security*, for some State that does not take care of them."

And after some further questions, Commissioner Healy stated, with reference to provisions in the new bill:

> "What would happen if the company went into bankruptcy would be this: *The people in your State should use up the deposit;* and then if it had not been paid for in full, when they came to take their share out of the national deposit, there would be an equalization process there, so that their share of the settlement recovered would be the same as everybody else's. But in the meantime *they would have that deposit.*"

In the afternoon of that day, Mr. Schenker made the following statement, in part:

> "The way the proposed law is set up, the Investors' Syndicate may form a new company after the enactment of this bill. They may stop selling in the old company, although they will make collections on certificates, so that *this bill in no way, Senator Herring, touches deposits that have been made to secure certificates issued up to the time of the passage* of this bill. • • • If such deposit is made and the company goes bankrupt, then *certifi-*

*cate holders of a State in which the deposit was made will get a preference* with respect to moneys realized on liquidation of this collateral. * * * So we have not abolished deposits. * * *

"Senator Herring. It will be just a question of whether a State will be willing for a company to do business in that State. In the case of our State, we will expect protection for certificate holders.

"Mr. Schenker. * * * In other words, this bill does not prevent any State in the future insisting upon a deposit for the protection of its certificate holders.

"Senator Wagner. In other words, *it does not change the present status.* I mean, so far as the requirement of a deposit is concerned.

"Mr. Schenker. That is right. (The bill makes an addition). The addition is that where you have a deposit in a State, and the certificate holders get a sum of money on that deposit, they cannot share in the general funds of the company until other people receive an amount equal to what the people in that State receive."

This is similar to the provision in the West Virginia depository law (Code 33-9-3), which provides that where a deposit is made in a State for the contract holders therein, they can only share in the West Virginia fund to the extent that a deposit was not made in their State fully to protect them, but the difference of the deposit was placed in the West Virginia fund for the benefit of the contract holders of that State.

Mr. Schenker went on to state, immediately following the above:

"So that if a security commissioner of a State has a 100 percent deposit, and a company goes

bankrupt, *the deposit he holds will be liquidated and certificate holders in that State will receive the money and be paid in full.*

"Senator Hughes. But they get the full benefit of their deposit?

"Mr. Schenker. Yes. And the securities commissioner of a State can require a deposit in any amount he wants.

"Senator Herring. I think that is all right."

Hearing, Part 4, pp. 1128-1129.

Senator Wagner, Chairman of the Committee on Banking and Currency, made the report accompanying the substitute bill (S-4108), the report number being 1775. With respect to the provisions concerning State deposits, Senator Wagner stated, in part:

"The bill *preserves the rights of residents* in those States which require specific deposits with their State officials."

On June 12, 1940, Representative William P. Cole, Jr., Chairman of the House Sub-Committee on Interstate and Foreign Commerce, introduced HR-10065, a companion bill to S-4108, and submitted Report No. 2639, which states, in part:

"Section 29. Bankruptcy of face-amount certificate companies, subsection (a); while *preserving the rights, even in the event of bankruptcy, of residents in those States which require specific deposits* with their State officials, * * *."

Therefore, Congress, in passing the Investment Company Act of 1940, specifically intended the deposits made with the States prior to January 1, 1941, to remain in those States, under the custody and control of the State

officers properly entitled thereto, and in the event of insolvency Congress especially intended that these deposits should be liquidated and distributed in the States, for the benefit of the contract holders in those States.

In any event, the provisions of the Act were to apply only to deposits made on contracts sold after January 1, 1941. In our instant case no deposit was made in any State after that date, so the deposits previously made were intended by Congress to be retained by the depository States.

**Congress Strictly Defined and Delimited Intervention by the S. E. C. in Insolvency Proceedings of Investment Companies Such as Fidelity, and Enacted Specific Provisions for Such Proceedings When Instituted Other than Under Chapter X.**

The S. E. C. in its original draft of the Investment Company Act of 1940, provided for wide discretionary powers by it with reference to investment companies, their reorganization and insolvencies. As stated in 50 Yale Law Journal 442:

> "While it was never seriously proposed to outlaw investment companies entirely, the original bill for Federal regulation, submitted by the S. E. C. to Congress (March 1940) surpassed even the Holding-Company Act in grants of discretionary power to the S. E. C. Whether it would have been politically possible to pass the bill in its original form is questionable. At any rate the present bill is a drastic modification . . . ."

As finally enacted, Section 3(a) defines investment companies, and subsection (2) includes companies selling face-amount certificates on the installment plan. There were only three of them then in existence in the United States, and Fidelity and Investors Syndicate, the two principal ones, were discussed by the S. E. C. with the

Congressional Committees. So the Act was definitely intended to cover Fidelity.

Section 25 of the Investment Company Act as passed by Congress is entitled "Plans of Reorganization." This section contains provisions concerning proceedings for reorganization of all investment companies, including face-amount certificate companies, instituted in *any* court of competent jurisdiction. Congress was not dealing with reorganization under Chapter X, because that was already law, and in (d), the final subsection of Section 25, Congress enacted that the section was not to derogate from or affect the powers of the Courts of the United States and the S. E. C. with reference to reorganizations contained in the Bankruptcy Act as amended. Also, subsection (c) provides for injunctive proceedings in District Courts to restrain these other proceedings under certain circumstances.

Therefore, Congress in enacting Section 25 clearly intended and recognized that investment companies, including face-amount certificate companies, could have reorganization proceedings in State Courts. A mere reading of this section will refute petitioners' contention that Congress intended all such proceedings to be under Chapter X, and under a Court with "national jurisdiction."

And Congress not only recognized the validity and legality of such State Court proceedings, but enacted into the Act the specific and limited part the S. E. C. could play therein. And this after a full hearing upon a bill presented by the S. E. C., giving that body, as above stated, practically unlimited supervisory jurisdiction and veto powers over such reorganization proceedings.

As stated in 50 Yale Law Journal 454:

> "The original draft of Section 25 gave the S. E. C. veto powers over reorganization plans unless they met the bankruptcy standard of being 'fair, equitable and feasible' . . . ." As finally redrafted, however, Section 25 gave the S. E. C. practically no powers over reorganization proceedings of investment companies, except for the possibility of the Commission exercising an extra statutory authority.

Therefore, we submit, Congress intentionally provided for and permitted proceedings such as those pending in the State Courts when the Chapter X proceedings were instituted, and apparently contemplated, as these respondents contend, that such proceedings could be consummated with only limited aid from the S. E. C.

Section 25(b) of the Investment Company Act provides that the S. E. C. is authorized, if requested by 25% of the holders of any class of securities, or by any registered investment company, to render an advisory report on plans of reorganization, which is then required to be mailed to interested persons. However, even if so requested, if the fairness or feasibility of such plan is in issue before *any Court* of competent jurisdiction, such report cannot be rendered unless submitted by the Court to the S. E. C. for that purpose.

Section 25(c) makes provision for those cases in which S. E. C. was not invited into the State Court proceedings, and gives that body certain rights and control over those proceedings nevertheless. This section provides:

> "Any [U. S.] district court [in the state of incorporation, or where the company maintains its principal place of business] is authorized to enjoin the consummation of any plan of reorganization

> * * * upon proceedings instituted by the Commission [who shall appear for the security holders], if such court shall determine any such plan to be grossly unfair or to constitute gross misconduct or gross abuse of trust on the part of the officers, directors * * * or other sponsors of such plan."

And this *is the full extent of the provision Congress made for S. E. C. participation in reorganization of investment companies*, including Fidelity, when not under Chapter X.

But it is stated in 50 Yale Law Journal 443:

> "Although the role of the S. E. C. is ostensibly little more than that of a watch dog, with power to enforce the Act by stop order, injunction or criminal prosecution, it seems likely that the Commission will exercise considerably greater power by way of persuasion than a literal reading of the Act would imply."

The Congressional intent is further discerned from Section 29(a) of the Investment Company Act, entitled "Bankruptcy of Face-Amount Certificate Companies," the section under discussion in the above colloquies between the S. E. C. and the Congressional Committee. While in Section 25 Congress dealt with reorganization of all categories of investment companies, including face-amount certificate companies, in Section 29(a) Congress set out special provisions dealing with bankruptcy of this latter class alone; and placed this section, enacted as part of the Investment Company Act, as an amendment to be at the end of Section 67 of the Bankruptcy Act of 1898 as amended; and Section 67 is in Chapter VII, or straight bankruptcy.

Subsection (f) (2) of Section 29(a) provides that deposits with State officials for protection of contracts sold

after *January 1, 1941*, shall be voidable at the option of the Trustee, if the company is insolvent and "cannot make full payment and discharge on account of all face-amount certificates sold by Debtor." But subsection (3), immediately following, provides the *liens created by the State deposits must be recognized and given effect*:

> "In the event any deposit or transfer described in paragraph 2 of this subsection (f) shall be avoided the trustee shall segregate the property received by the trustee from the depository and charge the same with the costs and expenses of maintenance and *liquidation* and *distribute the net proceeds thereof to the creditors who would have been entitled thereto under the provisions of the law or agreement providing for the deposit* or transfer of the property; * * *."

Congress made no provision for participation by the S. E. C. in bankruptcy of face-amount certificate companies, except under Section 29(b), which provides that the District Court alone shall appoint the Trustee, but only after notifying the S. E. C. and giving it an opportunity to be heard.

We again call the Court's attention to the use by Congress of the word "liquidation" in subsection (3), quoted immediately above.

This was not an oversight upon the part of the S. E. C. or Congress, because under former Section 77-B(c)(8) of the Bankruptcy Act the Judge, in addition to the reorganization powers conferred upon him by Section 77-B, could under certain circumstances "direct the estate to be liquidated, or direct the Trustees to liquidate the estate * * *."

Section 236 of Chapter X, together with Sections 237 and 238, were substituted in place thereof when Section 77-B was amended and became Chapter X, and were

specifically considered by Congress, as shown in the report of Senate Committee on the Judiciary, May 27, 1938, page 37. The provision of Section 77-B empowering the District Court to order liquidation of the debtor was not enacted into Chapter X, but instead the District Court under Section 236 of Chapter X has the option of dismissing the petition or adjudicating the debtor a bankrupt.

In other words, Congress in its original enactment on reorganization proceedings in Section 77-B had directed that liquidation could ensue in those 77-B reorganization proceedings in the event of failure of rehabilitation; but after due consideration, when it passed the Chandler Act amending Section 77-B into Chapter X, Congress expressly withdrew liquidation of corporations from reorganization proceedings. Instead the Court, under Sections 236, 237 and 238, in the event rehabilitation fails, can either dismiss the petition, or adjudicate the Debtor a bankrupt. In the latter event, Chapters I to VII of the Bankruptcy Act apply, which include no intervention by the S. E. C.

Further to show that Congress did know and realize the distinction between "rehabilitation" and "liquidation" is shown by 11 U. S. C. A., Section 203(i), providing for confirming a farmer's proposal by the Bankruptcy Court if satisfied "(1) it includes an equitable and feasible method of *liquidation* for secured creditors and of financial *rehabilitation* for the farmer * * *."

Likewise, the S. E. C., in its Report to Congress on the study, etc., of Protective and Reorganization Committees, Part VIII* at page 2, stated:

> "The term 'reorganization' in this, as in the foregoing parts of this report, is applied to all sorts

*Submitted by Jerome N. Frank, chairman, the study being headed by Mr. Justice Douglas during his period as chairman, p. iii.

of changes which affect the rights of security holders, except *actual liquidation under State statutes* or under the Bankruptcy Act."

The petitioners and the S. E. C. contend that only under Chapter X can liquidation proceed in a slow and orderly manner, and apparently take the position that straight bankruptcy requires something otherwise.

Chapter 2 of the Bankruptcy Act, Section 2(a) (5), provides that bankruptcy courts have the power to "authorize the business of the bankrupt to be conducted for limited periods by receivers, the marshal or trustee, if necessary in the best interests of the estate * * *." Subsection (7) permits the Court to "cause the assets of the bankrupt to be collected, reduced to money and distributed * * *." Therefore, there is nothing in Chapters 1 to 7 (straight bankruptcy) which requires speed or haste in regard to liquidation where it would be against the best interests of the bankrupt or of the creditors, and no need to stretch the reorganization provisions of Chapter X as enacted by Congress, to include liquidation therein, especially since it was taken out by Congress.

Therefore, we respectfully insist that our interpretation of the intent of Congress is sound. For liquidation of ordinary corporations straight bankruptcy is available; for reorganization of corporations (meaning rehabilitation), Congress, in September 1938, enacted Chapter X, and set forth the part the S. E. C. was to play therein. For bankrupt face-amount companies Congress, in August 1940, in the Investment Company Act of 1940, Section 29, amended the straight bankruptcy provisions of the Bankruptcy Act, and set forth a procedure for their liquidation, including an optional voiding by the Trustee of State deposits made after January 1, 1941, but with full recognition of all liens, trust relationships or other rights

acquired by virtue of the State statutes requiring the deposit, and with the S. E. C. to have no part therein.

For reorganization of investment companies, including face-amount certificate companies, Congress prescribed therefor in Section 25 of the Investment Company Act, and provided in (b) that under certain circumstances, the S. E. C. could be invited into such proceedings, to a limited extent, by the security holders, the company or the Court.†

Section 25 further provides in (c) that if the S. E. C. is not invited into the reorganization proceedings of investment companies, it may still exercise a degree of control over them, by having consummation of unfair or fraudulent plans enjoined in a Federal District Court.‡

Thus Congress rounded out its entire scheme or plan for insolvent corporations, which, we submit, should not be disrupted to permit the attorneys for the S. E. C. to carry their rights and duties from one category or class into all the others; especially when there is no urgent need therefor, and in opposition to the expressed intent of Congress.

So, it is respectfully submitted that Congress did not intend an annuity company such as Fidelity, in any event, to partake of the provisions of Chapter X for liquidation purposes, and it is further submitted that Congress particularly was careful to avoid the enactment of legislation which upon insolvency would in any way disturb the deposits made with the States, or the trust liens of the contract holders thereby acquired; and Congress expressly recognized that liquidation of investment companies, such as was Fidelity, could take place in State Courts.

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†Congress apparently recognized that reorganization of investment companies were for State Courts, because had Congress intended them to be under Chapter X, no such invitation to the S. E. C. would be necessary.

‡This also indicates Congressional contemplation and recognition of investment company reorganizations in State Courts.

C

**Securities were deposited in trust with States or State officials by Fidelity as required by valid State laws, for the benefit and protection of the purchasers and holders of Fidelity contracts in those States, and such securities so deposited should not now be taken from those States or State officials, and the trust lien thereby created in favor of the contract holders in each such State should not be nullified or avoided.**

The typical contract sold by Fidelity had a provision in Section 1 that the reserve fund "shall be invested in approved securities and deposited in trust as required by the laws of the State of West Virginia," or "shall be invested in securities and deposited with State authorities in trust."

The applicable feature of the West Virginia law (Code 33-9-3) requires that securities approved by the Insurance Commissioner shall be deposited "with the State Treasurer * * * in trust, for the benefit of its contract holders."

It is uncontrovertible that a State may make such reasonable restrictions as it desires before permitting a charter to be issued for a domestic corporation and before permitting it to receive a license to do business in the State, and the deposit law of West Virginia, so far as it concerns Fidelity, a West Virginia corporation, is, of course, unchallenged.

With regard to the other depository States, the deposit is exactly the same as that required of a foreign insurance company as a condition prerequisite to its being permitted to engage in business within the State, and this Court early upheld the constitutionality of State statutes requiring a deposit for the protection and benefit of local citizens of a State before a foreign insurance company

would be permitted to do business in the State. *Paul* v. *Virginia*, 75 U. S. 168, 19 L. Ed. 357. In upholding the constitutionality of such a Virginia statute, this Court stated: "They may exclude the foreign corporation entirely * * * or they may exact such security for the performance of its contracts with their citizens as in their judgment would best promote the public interest. The whole matter rests in their discretion."

*In re Bajardi*, 8 F. (2d) 551:

> "The power of the State to require the deposit of the securities as a condition precedent to the transaction of business in this State is unquestioned."[8]

The rights of such insurance companies are governed by the statutes in force in the State when the securities are deposited therein, and the interpretation thereof by the Courts of the State. *Lawson* v. *Aetna Ins. Co.* (W. Va.), 41 F. (2d) 316.

Therefore, there can be no real challenge to the validity of the laws requiring the State deposits.

**The State Deposits Constitute Trust Funds for the Benefit of the Contract Holders Which May Not Be Avoided or Nullified**

There were fifteen States in the United States which required and received a deposit by Fidelity, and there are thirty-six States in the United States which required and received a deposit from either Fidelity or Investors Syndicate, the other company doing a similar annuity business to that of Fidelity. The question then arises whether, upon insolvency of the depositing company, such a deposit of securities made in compliance with valid State statutes can or should be retained and administered by the State authorities with whom the deposit was made, and whether such deposited securities in each State were

[8] See accord 29 R. C. L. 68, Sec. 32.

trust funds for the benefit of contract holders in those States, which trust liens should not be destroyed or set aside.

This Court decided (1898) the status of such funds deposited with States, in the case of *Blake* v. *McClung*, 172 U. S. 239, 43 L. Ed. 432, at 439.

The actual decision in that case was that a statute of Tennessee in giving a preference in the distribution of the assets of an insolvent foreign corporation was unconstitutional, but the Court in its decision stated:*

> "* * * the objections to the statutes of Tennessee do not necessarily embrace enactments that are found in some of the States requiring foreign insurance companies, as a condition of their coming into the State for the purposes of business, to deposit with the state treasurer funds sufficient to secure policy-holders in its midst. *Legislation of that character does not present any question of discrimination against citizens forbidden by the Constitution.* Insurance funds set apart in advance for the benefit of home policy owners of a foreign insurance corporation doing business in the State are a *trust fund of a specific kind to be administered for the exclusive benefit of certain persons*, * * * funds or property *specifically set aside as a trust fund, and at the outset put into the custody of the state, for the exclusive benefit, or for the benefit primarily, of Tennessee creditors*, * * *."

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*Because of the pertinency we quote at length.

†The digests state the general rule and the reasons therefor:
In 104 A. L. R. 748, 749:

"In order to protect the interests of residents in their dealings with foreign corporations most States have adopted statutes requiring foreign corporations, and more especially insurance, surety, or other corporations, * * * to deposit with the State, as a prerequisite to their doing business therein, securities or a

And recently this Court held that such deposit cannot be taken from possession of the State official holding it, and domestic creditors may have exclusive remedy against the fund, if such is the policy of the depository State.

In the case of *Fischer* v. *American Life Ins. Co.*, 314 U. S. 549, 86 L. Ed. 328, Mr. Fischer, Commissioner of Insurance of the State of Iowa (also a respondent in the case at bar), as such, was the custodian of a deposit made by a foreign insurance company in the State of Iowa for the benefit of policyholders in that State, which company later became insolvent. The policies were re-insured by a Michigan company, the deposit remaining unchanged, and then the re-insuring company became insolvent. Mr. Fischer instituted his proper suit in State Court for the administration and distribution of said deposit for the benefit of the Iowa policyholders, and because of the claim by the Michigan receiver that the latter "had title to all of its assets wherever situated," Mr. Fischer brought a suit in Federal Court to remove an encumbrance, lien or cloud upon the title of the property. This Court held that:

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bond, * * * and the Courts are inclined zealously to guard the rights of residents arising under such statutes.

"* * * by the interpretation of most Courts it (the deposit) is considered *as a trust held by the State for the protection of those doing business with the corporation.*

* * *

"* * * in the majority of cases the Courts have held that such protection extended only to such resident claimants."

In 29 R. C. L. 69-70, Sec. 32, it is further stated:

"*The deposits constitute a special trust fund* for the purpose of meeting the depository company's policy obligations arising out of the transaction of business within the State, and may be subject thereto."

Again at 29 R. C. L. 107-108, Sec. 81:

"Generally a deposit with a State official creates *a trust* for the benefit of policy holders in case of insolvency, to the exclusion of other claims."

And in 29 R. C. L. 108, Sec. 82:

"Requirement of funds or deposits from foreign insurance companies are generally regarded as having for their purpose the protection of the resident claimants."

> "* * * even if that claim of the Michigan Receiver were true, that nevertheless claimants entitled to the benefit of the fund in Iowa might pursue their suits and remedies against it and in derogation of the claim of the Michigan Receiver if that were Iowa's policy. *Clark* v. *Willard*, 294 U. S. 211. That is the asserted Iowa policy here. The Iowa Receiver is in possession of the securities in question; * * *."

and

> "We repeat that neither Michigan nor Texas is entitled to the securities if such a disposition of them would contravene Iowa law."

The Federal Courts in *In re Bajardi*, 8 F. (2d) 551, and in *In re Rosett*, 204 F. 431, have held that "the proceeds of the securities there deposited are impressed with the trust and must be applied and distributed as provided in" State statutes. See also *Firemen's Insurance Co.* v. *Hemmingway*, Fed. Case No. 4794.

A number of State Courts likewise have made decisions regarding deposits made with the States, and unanimously uphold the contention of these respondents, that such deposits are *trust funds for the benefit and protection of domestic creditors and policyholders*, and in the event of insolvency of the depository company, are to be retained in and by the depository State.*

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*Lewis v. *American Savings & Loan Ass'n*, 98 Wis. 203, 73 N. W. 793.
*Phillips* v. *Perue*, 111 Tex. 112, 229 S. W. 849.
*State ex rel. Stevenson* v. *Stephens*, 136 Mo. 537, 37 S. W. 506.
*Texas F. Bonding Co.* v. *Austin* (Tex.), 246 S. W. 1026.
*Senter* v. *Lockhart, Treasurer* (Tex.), 82 S. W. (2d) 375.
*Crowell* v. *Carroll* (Tex.), 250 S. W. 252.
*In re Phillips*, 200 N. Y. S. 639.
*People* v. *Granite State Provident Ass'n*, 161 N. Y. 402, 55 N. E. 1053.
*In re Stoddard*, 238 N. Y. 147, 144 N. E. 484.
*In re Stoddard*, 242 N. Y. 148, 151 N. E. 159.
*State ex rel. Turner* v. *Union Casualty Ins. Co.*, 8 Ohio App. 285, 39 Ohio C. C. 491 (Motion to certify record overruled).
*State ex rel. Hutchinson* (S. C.), 189 S. E. 475.
*Boynton* v. *Consolidated Indemnity Ins. Co.* (S. C.), 185 S. E. 734.
*Pink* v. *McColley* (Ga.), 18 S. E. (2d) 3.
*Manufacturing Lumberman's U.* v. *S. Georgia R. Co.* (Ga.), 196 S. E. 244.

*Rollo, Assignee,* v. *Andes Ins. Co.,* (Va.), 23 Gratt. 509:

> "The treasurer is required by the statute to retain the securities in the treasury for the special objects contemplated by the act, until the liabilities of the company are settled or terminated. So long as any thing remains to be done, so long as these liabilities continue, he is expressly prohibited from disposing of or surrendering them. * * * He *holds the securities in trust, to be administered, first for the people of Virginia, and then for the company making the deposit.* This is the distinction given them by law, controlling not only the treasurer but the courts also; and it would seem there is no power, except that of the Legislature, to change such destination [distinction?].
>
> "* * * The theory of this whole legislation is, that a foreign insurance company may come into the State, deposit its funds and securities with the treasurer, and carry on business here for an indefinite period. However long this may continue, *the securities deposited cannot be surrendered or subjected to the claims of creditors.* If this exemption be wrong, * * * the policy of this legislation is bad, and ought to be abandoned."

And this Court in *Straton* v. *New,* 283 U. S. 318, 75 L. Ed. 1060, held that in the distribution of the estate of a bankrupt that liens acquired, if valid under State law, are preserved and must be accorded priority, in accordance with applicable local law.

Even the S. E. C. in substance admitted in its brief in the Circuit Court of Appeals, below, that these trust liens created by State statute cannot be avoided, when it stated (Brief, p. 52), "The rights of contract holders by State statutes *will be recognized* appropriately by the Federal Courts in the proceedings."

Therefore, it is respectfully submitted that the securities deposited in each State should remain in that State, and with the official designated by statute of the State to receive and hold and administer that deposit, and that the States cannot and should not be compelled to turn over the deposited securities to the Central Trust Company, Trustee; and that the trust created, and the beneficial ownership and the trust liens of the contract holders in each such State should not be nullified or set aside.

**The Federal Court Under Its Equity Powers Should Release Its Jurisdiction, If Any, in Favor of the State Courts**

In the case of *Securities & Exchange Commission* v. *U. S. Realty and Improvement Co.*, 310 U. S. 434, 84 L. Ed. 1293, this Court held that the question therein was based "on considerations growing out of the public policy of the [Chandler] Act * * * and of *the authority of the Court clothed with equity powers and sitting in bankruptcy* to give effect to that policy * * *," and that "*a bankruptcy court is a court of equity*, and is guided by equitable doctrines and principles except in so far as they are inconsistent with the Act. * * * A court of equity in its discretion * * * may in the public interest, even withhold relief altogether; and it would seem that it is bound to stay its hand in the public interest when it reasonably appears that private right will not suffer. *Pennsylvania* v. *Williams*, * * *. This interest of the [S. E. C.] does not differ from that of a liquidator under a state statutory proceeding who may, in a proper case, intervene in an equity receivership in a federal court to ask the court to relinquish its jurisdiction in favor of the state proceeding. *Pennsylvania* v. *Williams*, * * *. Their [State Banking Commission] only interest, like that of the Commission, is a public one, to maintain the state authority and to secure a liquidation in conformity to state policy."

We submit that this Court should again follow the rule and reasoning of *Pennsylvania* v. *Williams*, 294 U. S. 176, 79 L. Ed. 841, because of the similarity of that case to the case at bar. While the case at bar is under Chapter X, and the former case involved a Federal equity proceeding, which had been instituted prior to the State Court proceedings, however, *since a bankruptcy court is in reality a court of equity*, the same principles should be applicable.

In *Pennsylvania* v. *Williams*, there was a contest between a Federal equity proceeding alleging insolvency and asking for appointment of receivers, and the Secretary of Banking of Pennsylvania, desiring to liquidate an insolvent banking company under Pennsylvania statutes particularly enacted to provide for that kind of a company. It was held that the District Court had jurisdiction and could have made the liquidation, but that under the circumstances the equity discretion of the District Court invoked by the petition of the Banking Commissioner was such that the Court should have relinquished its jurisdiction "in favor of the statutory administration of the corporation assets by the State officer," this Court stating:

> "It has long been accepted practice for Federal Courts to relinquish their jurisdiction in favor of the State Courts where its exercise would involve control of, or interference with, the internal affairs of a domestic corporation of the State. (Cases cited.) *There are stronger reasons for adopting a like practice where the exercise of jurisdiction involves an unnecessary interference by injunction with the lawful actions of State officials.*"

The italicized words are particularly and peculiarly pertinent to the case at bar.

In the case of *Gordon* v. *Ominskey*, 294 U. S. 186, 79 L. Ed. 848, a somewhat similar question was involved, with this Court again holding the District Court had acquired jurisdiction of the cause, but that upon the request of the Secretary of Banking of Pennsylvania, showing possession and control of the assets by him, pursuant to statute, the District Court, under *Pennsylvania* v. *Williams*, should have been induced by the same considerations to relinquish its jurisdiction to the State Courts.

In *Pennsylvania General Casualty Co.* v. *Pennsylvania*, 294 U. S. 189, 79 L. Ed. 850, there was a Federal Court suit to liquidate an insurance company and a similar State Court proceeding under the statutes of Pennsylvania by the Insurance Commissioner, with injunctions against interference being issued by each Court, and again the Federal Court had acquired its jurisdiction in the case because the bill there was first presented.

This Court held that the District Court's authority to entertain the suit was not restricted by the procedure of the local statute for liquidation of insurance companies, and that it had rightfully acquired jurisdiction, but that the end result "in the State Court is the liquidation of a domestic insurance company by a State officer, and in the absence of a showing that the interest of creditors and share holders would not be adequately protected by this procedure, the case was a proper one for the District Court in the exercise of judicial discretion to relinquish its jurisdiction in favor of the administration by the State officer."

This policy, so clearly expressed by this Court, of allowing the continuation of State statutory proceedings by State officials for liquidation of domestic companies, even though the Federal Court had jurisdiction of the

cause and had first acquired its jurisdiction, we believe should be a guiding principle in the case at bar.

Here the officials of six States are respondents and there are eight additional States wherein Fidelity made a deposit, joined with them *amici curiae* requesting this Court that they be permitted to continue their prior pending State proceedings to liquidate Fidelity. There are also a number of other States appearing *amici curiae* herein, all of which together total approximately one-half the States of the United States, which are respectfully urging this Court, through their Attorney Generals and other proper State officials, that depository statutes such as those in question in the case at bar be held valid, that the trusts thereby created be not nullified or avoided, and that in the event of insolvency the State officials with whom the deposits are made and who, by the statutes and laws of the States, are required to act in regard thereto, be permitted so to do, even though Chapter X proceedings are instituted.

Nearly every State has laws requiring deposits by foreign corporations, particularly insurance companies, wherein deposits must be made as a condition prerequisite to doing business in the State. It is not beyond the realm of possibility that in the future Congress may enact legislation extending the Bankruptcy Act to include insurance and other companies now exempt. If the decision of the District Court in the case at bar be upheld by this Court, and *Blake* v. *McClung*, supra, and the decision of the Court below overruled, it would mean that in the event of insolvency, the first District Court acquiring jurisdiction could require all deposits made in compliance with State law, by insurance and other such companies, to be turned over to a Trustee appointed by that Federal Court; it would permit the trust liens existing by virtue of the State depository laws in favor of domestic creditors

and policyholders to be nullified. It could literally cause millions of people to be compelled to go to a distant and foreign Federal jurisdiction to protect their rights. It is to urge this Court to decide against any such invasion of rights of the sovereign States that many of the States have enjoined in the *amici curiae* brief.

That the District Court fully intends, and believes it has the power and authority, to compel a turn-over of the State deposits to the Federal Trustee, is clear from the record. These respondents are not jousting with a shadow. Even the S. E. C. brief now advocates not only taking the deposited securities from the States, but nullifying the trust liens created by the State statutes (Brief, p. 37).

The District Court entered the turn-over order of June 6, 1941 (R. 2), and strengthened it on June 10, 1941 (R. 13); although the West Virginia respondents moved for a stay in its enforcement until the legal questions were determined, this was refused. (R. 15, 19.) The turn-over orders were amended to freezing orders on August 9, 1941 (R. 108), except the turn-over against the West Virginia State Court Receivers was not amended (R. 107). The Court expressly reserved the right to extend or modify this freezing order at any time (R. 109).

During the hearing the District Court informed Assistant Attorney General W. F. Gray of Illinois, in the record, that if jurisdiction was sustained, the Federal Trustee was to have the management of the Illinois deposit, and *if the company was liquidated, the Court had the right to require liquidation through its trustee* (R. 958).

Lastly, at the end of its written opinion in this case (R. 202), the District Court held that the State officials and Receivers were not adverse claimants. "No plenary suit is required in dealing with them. The assertion of

adverse claims, being merely assertion and no more, may be disposed of summarily, *as I have done.*"

That meant, and means, that the District Court believes it has already decided it can take the State deposits of securities from the custodians thereof, and put them under the control of its Trustee. And that is the very thing which the respondents, together with all the States appearing *amici curiae*, are so strongly contending against, and so earnestly urge this Court to prohibit.

In straight bankruptcy, the State officials, as trustees or lienholders, could liquidate the deposited securities in their possession, turning over to the trustee only the balances, if any, remaining. Hence the bitter fight by petitioners to retain the proceedings in Chapter X, and the attempt to stretch its provisions to include liquidation; all for the sole purpose of taking these deposited securities from the possession of the States and their officials, and turning them over en masse to the Federal Trustee appointed under Chapter X, and nullifying or destroying the trust liens created by State statute, as the brief of the S. E. C. advocates.

We respectfully but earnestly submit that under the equity powers of the Bankruptcy Court, this Court should follow *Pennsylvania* v. *Williams* and the other similar decisions and grant the request of these States, as prayed for by the West Virginia respondents in paragraph XV of their answer filed in the District Court (R. 78), and permit the deposited securities to be retained by the State officials, and the trust liens to be left undisturbed.

D

**The Eleventh Amendment to the Constitution of the United States provides immunity to the Sovereign States holding deposits, and to the State officials in whose custody, possession and control are the State deposits, from suit or order by the District Court to such State officials concerning such deposits, and effectively prohibits a compulsory turn-over of said deposits to the Trustee under Chapter X.**

The West Virginia respondents contend the deposit in West Virginia was made with the Sovereign State of West Virginia, and that the District Court was prohibited by the Eleventh Amendment to the Constitution of the United States from entering the turn-over orders of June 6th and 10th, 1941, and the "freezing" injunctive order of August 9th, 1941, against the States, or their officials; and therefore cannot take custody and possession of the deposited securities from the State officials. Since, then, the District Court is thus prohibited from exercising control over these deposited securities, and since they are substantially the only assets of the Debtor, Fidelity, it follows that reorganization of Fidelity cannot be had in Chapter X proceedings.

Following the lead of Virginia, the Mother State of West Virginia, which in 1866 enacted a requirement for a deposit to be made with the Insurance Commissioner by any foreign insurance company which came into the State to do business, such deposit to be for the benefit of the policyholders in that State, West Virginia first enacted such a law in 1867, which has been continued to the present time (Code 33-2-7).

In 1911 West Virginia first enacted legislation permitting a company, other than a life insurance company, to be licensed in West Virginia for the purpose of selling

annuities. The legislation at that time required a minimum deposit with the Insurance Commissioner of $10,000.00, and an additional deposit of securities to an amount of 100% of all its liabilities "on contracts outstanding in this State * * * in trust, for the benefit of its contract holders."

In 1921 the legislation was changed to require a $100,000.00 deposit in addition to a deposit "equal to 100% of the liability on outstanding contracts." In 1929 the law was again changed so where the deposit had formerly been required to be with the Insurance Commissioner, thereafter only the additional deposit for other States was to be made with him. Thereafter, in 1930, when the Code of West Virginia was revised, this was again amended so that the statutory law of West Virginia (Code 33-9-3) reads:

> "The Insurance Commissioner shall require the applicant to deposit with the State Treasurer (in accordance with Article 5, Chapter 12 of this Code), in trust, for the benefit of its contract holders, * * * securities * * * as may be approved by such Insurance Commissioner * * * to the aggregate amount of $100,000.00, and in addition to such deposit, such * * * corporation shall maintain at all times a deposit with the State Treasurer of bonds and securities, approved by the Insurance Commissioner, to an amount equal to the total amount which such * * * corporation may be liable to pay in cash to the holders of all contracts under the terms thereof at the time of the deposit; * * *".

The provisions concerning deposits made with other States then follow. (Set out in the Statement [supra].)

For the purpose of the instant argument, we will restate the pertinent part of the above statute and put in place of the parentheses the exact words of the relevant

part of Section 2 of Article 5, Chapter 12, so that the deposit law reads:

> "* * * the applicant to deposit with the State Treasurer (who shall be the custodian of all securities belonging to the State of West Virginia or by law required to be deposited with the State or held in legal custody by the State), in trust, for the benefit of its contract holders, * * *."

It is the contention of the West Virginia respondents that by this language the Legislature of West Virginia intended the deposit of securities to be made with the *Sovereign State* of West Virginia, and designated the Treasurer of West Virginia as the official custodian of such deposit, with the Insurance Commissioner of West Virginia having supervision and authority thereover.

This contention is substantiated by the fact that in 1941 the Legislature amended Code 12-5-2 by adding a paragraph thereto, by which the Board of Public Works of West Virginia could fix "fair and reasonable charges for the care, custody, exchange and substitution of securities deposited by insurance companies and companies issuing annuity contracts" and deposit such charge "in the State fund general revenue." Thus the State could charge the depositor of these trust funds for expenses, as would the trustee of any conventional trust charge the settler thereof, and these charges became a part of the State's *general revenue*.

Also, in 1939, the Legislature amended Chapter 12, Article 5, by adding a new section, number 6. (Code 12-5-6.) It provided that where an approved deposit be required by statute, it may "be deemed to include and mean notes executed * * * and made payable to the *State of West Virginia*, upon demand, in the event of insolvency or default by such person or corporation, for the benefit

of those for whom such securities are deposited * * *" if the deposit were not being made with the *Sovereign State* itself, then why the legislative requirement that the notes be made payable to the *State of West Virginia*?

If this contention is sound, then the Eleventh Amendment is an absolute bar to any order or suit in any Court against this fund held by the Sovereign State of West Virginia, except such suits or actions as the Legislature has seen fit to authorize to be instituted for or by the State of West Virginia or its proper officials with relation to said deposit. The Constitution of West Virginia itself, Article VI, Section 35 (Appendix, Part II), prohibits the State of West Virginia being made a defendant in any court of law or equity; and the State of West Virginia has permitted no such suits or actions, except the suit of the Auditor in the Circuit Court of Kanawha County (Code 33-2-45).

The first decision directly sustaining this contention of respondents was made in Virginia shortly after the separation of West Virginia therefrom, and such a decision, while not absolutely binding authority in the State of West Virginia, is persuasive authority of the very highest kind.

In *Rollo, Assignee*, v. *Andes Ins. Co.*, 23 Gratt. (Va.) 509 (1873), a deposit had been made with the State Treasurer of Virginia by a non-domestic insurance company, as required by statute. A judgment creditor from still a different State brought an attachment and garnishment suit against the State Treasurer for payment of his judgment against the insurance company, procured in that foreign jurisdiction.

In holding that such attachment would not lie against the deposited fund and the garnishment action could not

be maintained against the State Treasurer, the Court said specifically:[16]

> "Something more is involved than the rights and obligations of the treasurer. *It is a question that concerns the State.* It is certainly not compatible with her sovereignty, and dignity to be arraigned before her own tribunals, at the suit of individuals, in any other mode than is prescribed by her statutes. Nor is it consistent with her interests, nor the proper administration of public affairs, that her officers shall be arrested in their public duties, and required to answer before the courts for funds or securities committed to their custody for a specific purpose, under authority of a public law. The treasurer of the State is one of the most important officers of the commonwealth, with grave, arduous and difficult duties to perform. It is impossible to foresee the mischiefs and embarrassments that will ensue, if, in addition to these duties, he is to be involved in the conflicts of creditors, to answer innumerable rival attachments, employ counsel, answer interrogatories, and otherwise consume time and attention which should be devoted exclusively to the public interests."

The facts in *State ex rel. Stephenson* v. *Stephens*, 136 Mo. 537, 37 S. W. 806, are nearly identical with those of the instant case. Under Missouri laws passed in 1889 (Sec. 8662) a deposit was required of a Montana "installment investment bond company," coming into the State to do business. In 1893 legislation was enacted for winding up such companies in event of failure, and for liquidation and distribution of their assets. In interpreting this latter statute after insolvency of the depository company, the Court held that the deposit had been

[16]Again we quote at length only because of the special pertinency.

made with the *State* of Missouri, even though it did not thereby become a part of the general funds of that State.

In *Blake* v. *McClung*, 172 U. S. 239, 43 L. Ed. 432, this Court, in speaking of a deposit of securities by a foreign insurance company made with a State Treasurer as a condition prerequisite to doing business in the State, said:

> "* * * funds or property specifically set aside as a trust fund, and at the outset put into the *custody of the State*, for the exclusive benefit, or the benefit primarily, of Tennessee creditors, * * *."

In 104 A. L. R. 748, the annotator, speaking of deposits by foreign insurance companies as a condition of doing business within a State, states:

> "Most courts hold such a deposit is considered as a trust held *by the State* for the protection of those doing business with the corporation."

The specific contention herein raised by the West Virginia respondents that because of the Eleventh Amendment, State officials having custody of a deposit made with a *State* under valid State statutes have immunity from suit or order of any Court was sustained by this Court in *Lankford* v. *Platte Iron Works Co.*, 235 U. S. 461, 59 L. Ed. 316, and *Farish* v. *State Banking Board*, 235 U. S. 498, 59 L. Ed. 330, which have never been overruled nor modified. In those cases there was a fund created by the statutes of Oklahoma for the purpose of repayment of deposits in insolvent Oklahoma banks, which fund was placed under the supervision of the Banking Board of Oklahoma. The Iron Works filed a bill in equity to compel payment of its certificates of deposit in an insolvent bank out of this fund for guaranty of deposits. This Court held that the property was that of the banks who contributed to the fund "and is accumulated in a

fund for the security of their respective depositories," and then held:

> "The *State* can be said to be a necessary party in the pending case because of its interest that the fund which it has caused to be created in pursuance of its policy shall be administered by the officers it has appointed rather than by judicial tribunals."

This Court then said that since such a construction could be given, it was necessary to consider the decision of State tribunals thereon. After discussing such decisions, this Court dismissed the action on the ground that the State Banking Board was immune from suit under the Eleventh Amendment, even though the contention was made that the fund was not under the executive or legislative control of the State and could be used solely for the purpose of paying depositors of failed banks; in other words, that the fund was held in trust for private persons, and that the State had no pecuniary interest therein. This Court held that at least the fund was under the management of the *State* through its officers; that the Federal Court had no jurisdiction to subject the management of its fund to judicial control.

The Sovereign State of West Virginia and any other State as such can be a legal trustee and hold title to the deposited property, even though there is no remedy against the State to enforce the trust. Restatement of the Law on Trusts 264, Section 95.

> "The United States or a State has the capacity to take and hold property in trust, but in the absence of a statute otherwise providing, the trust is not enforceable against the United States or a State."

Even should it be held that the deposit was only made

or required to be made with an official of the State, yet the Eleventh Amendment gives him an immunity from any order or injunction which restrains him from performing his duties, such as those required by the valid West Virginia statutes.

As stated in *Ex parte Ayres*, 123 U. S. 443, 31 L. Ed. 216:

> "* * * The very object and purpose of the Eleventh Amendment were to prevent the indignity of subjecting a State to the coercive process of judicial tribunals at the instance of private parties. It was thought to be neither becoming nor convenient that the several States of the Union, invested with that large residuum of sovereignty which had not been delegated to the United States, should be summoned as defendants to answer the complaints of private persons, * * * or that the course of their public policy and the administration of their public affairs should be subject to and controlled by the mandates of judicial tribunals without their consent, * * * *. In this spirit *it must be held to cover, not only suits brought against a State by name, but those also against its officers, agents, and representatives,* * * *."

The Eleventh Amendment will bar action against the State officer named as a defendant where he has no personal interest but is acting solely for and on behalf of the State.*

*Mitchell* v. *Lay*, 48 F. (2d) 79 (C. C. A. 9), certiorari denied 283 U. S. 864, dealt with an insolvent Texas insur-

*Louisiana* v. *Jumel*, 107 U. S. 711; *Cunningham* v. *Macon & Brunswick R. R. Co.*, 109 U. S. 446; *Hagood* v. *Southern*, 117 U. S. 52; *Murray* v. *Wilson Distilling Co.*, 213 U. S. 151; *Worcester County Co.* v. *Riley*, 302 U. S. 292; and *Read* v. *National Equity Life Ins. Co.*, 114 F. (2d) 977.

See also, *Beers* v. *Arkansas*, 61 U. S. 527, 15 L. Ed. 991, and *Missouri* v. *Fiske*, 290 U. S. 18, 78 L. Ed. 145.

ance company which had made a deposit required by statute in California. After institution of insolvency proceedings in Texas, the Insurance Commissioner of California instituted proceedings in his State Court as provided by statute. A Federal Court proceeding was instituted, ancillary to the Texas proceedings, and therein the District Court enjoined the Insurance Commissioner of California from proceeding further in the State receivership proceedings and from interfering with the Federal Court Trustee's possession of the Debtor's deposited assets. In effect, a turn-over and injunction order, the same as in the case at bar.

That Insurance Commissioner likewise appealed from the ruling, and in reversing the decision of the District Court and holding the injunction and turn-over order invalid, the Circuit Court of Appeals held:

> "• • • This injunction prohibits the Insurance Commissioner from performing the duties imposed upon him by State statute (liquidation of insolvent companies). The order directs the Insurance Commissioner to violate his official duties under such statute by turning over to the receiver of the Federal Court *a fund that was in the custody of the State* through its officers for the protection of the creditors of insolvent insurance companies before this action was begun."

And the Court stated this injunction order was entered because the Insurance Commissioner was doing his duty, not because he was neglecting it.

> "The mere statement of this situation is sufficient to show the impropriety of the order of the District Court. • • • The Federal Court had no right to enjoin the further prosecution of that action."

The highest Courts of West Virginia and Virginia, have by their decided cases upheld the exclusive jurisdic-

tion of the administrative bodies of the State and its agents and appointees, holding that the administrative bodies are such a part of the Sovereign State as to be immune from suit under the Constitution; and permitting exclusive control by those administrative agencies of matter placed by statute under their control.[11]

In *Picklesimer* v. *Morris*, 101 W. Va. 127, 132 S. E. 372, the West Virginia Commissioner of Banking had appointed a receiver for an insolvent bank, and the Supreme Court of Appeals of West Virginia held that thereafter a West Virginia Circuit Court had no power or jurisdiction to entertain a general creditors' suit and appoint equity receivers therein for that insolvent bank.

Therefore, the West Virginia respondents respectfully submit that there is and was no jurisdiction of the District Court to entertain any proceedings, or to enter any order, or issue any injunction against the Auditor or Treasurer of the State of West Virginia (and the officials of other depository States), concerning the funds deposited with the State of West Virginia (and other depository States), in the custory of the Treasurer, and under the authority and control of the Auditor, which were deposited in compliance with valid and applicable State statutes.

Particularly must this be true since legal title to the securities which had been deposited was vested in the State authorities in the States of Alabama, Iowa, Maryland, Wisconsin and West Virginia (Code 33-9-3 and 10), either by the requirements of their depository law, or the order or decree of a State Court, prior to the institu-

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[11] *Sayers* v. *Bullar*, 22 S. E. (2d) 9 (Oct. 12, 1942).
*Carwile* v. *Commonwealth* (Va.), certiorari denied Jan. 11, 1943, 11 L. W. 3209.
*Mahone* v. *State Road Commission*, 99 W. Va. 397, 129 S. E. 320.
*Gordon* v. *State Board of Control*, 85 W. Va. 739, 102 S. E. 688.
*Miller* v. *State Board of Agriculture*, 46 W. Va. 192, 32 S. E. 1007.
*State ex rel. P. S. C.* v. *B. & O. R. R. Co.*, 76 W. Va. 399, 85 S. E. 714.

tion of the Chapter X proceedings. (See Appendix, Part III.)

As Mr. Justice Miller stated in his famous dissent in *B. & O. R. R. Co. v. Baugh*, 149 U. S. 368, 37 L. Ed. 772, cited by this Court with approval in *Erie R. Co. v. Tompkins*, 304 U. S. 64,

> "• • • The Constitution of the United States recognizes and preserves the autonomy and independence (of the States) in their legislation and independence in their judicial departments • • • (and) any interference with either • • • is an invasion of the authority of the States, and to that extent a denial of its independence."

## II

## THE STATE COURTS IN THE STATES IN WHICH THE DEPOSITS ARE LOCATED ARE BEST FITTED TO INTERPRET AND DECIDE THE STATE DEPOSITORY LAW UNDER WHICH THE DEPOSITS MUST BE DISTRIBUTED TO THE CONTRACT HOLDERS IN EACH SUCH STATE.

### State Courts Should Interpret State Depository Statutes

As held in *Guaranty Trust Co. v. Blodgett*, 287 U. S. 509, 513, the existing statutes of a State when applicable must be considered by Federal Courts in the same manner as if the words of the State law had been adopted, and specifically reenacted by Act of Congress; and as held in *Knights of Pythias v. Miles*, 255 U. S. 559, 65 L. Ed. 785, the Supreme Court of the United States must accept the construction given to a State statute by the highest Court of the State as though it were specifically expressed in the statute. We believe it is axiomatic that in deter-

mining questions as to title of property the Federal Courts are bound to apply the laws and rules of property of the State in which the property is situate, and to decide the controversy as the State Court would, and that in the administration of the local law of a State that the Courts of the United States follow implicitly the settled decisions of the Courts of last resort of the State in question. See notes in 6 L. Ed. 290; 18 L. Ed. 350.

*Glenn* v. *Field Packing Company*, 290 U. S. 177.
*Hartford Accident & Indemnity Co.* v. *Nelson Mfg. Co.*, 291 U. S. 352, at 358.
*Lee* v. *Bickell*, 292 U. S. 415, at 425, 426.

The Trustee, one of petitioners herein, in its brief filed in the Circuit Court of Appeals, stated (p. 8):

> "Since the (depository) statutes vary widely in their language, it is probable that no uniform construction can be applied to them, and that each must be construed according to its own terms."

With that we agree.

Therefore, in the case at bar, it is apparently agreed that the right of the contract holders in each State will be determined by the depository law thereof, since the Trustee in that brief also stated (p. 9):

> "Whatever effect any State statute requiring the deposit of assets therein may have upon the rights of the creditors in that State can be as well determined by the Federal Court as by the State Courts.";

and the S. E. C. in its brief in the Circuit Court of Appeals stated (p. 52):

> "The rights of contract holders by State statutes will be recognized appropriately by the Federal

> Courts in the proceedings. We do contend the assets should be administered in the Bankruptcy Court and the rights under the State depository statutes there determined and recognized."

Therefore, the question for determination is *whether petitioners have proven that the Bankruptcy Court is more capable of interpreting and deciding the meaning of the State depository laws than the Courts of the States where legislatures enacted them*, and whose contract holders' rights are affected thereby.

This Court has repeatedly stated that questions of State law are for the decision of State Courts. In *Clark* v. *Willard*, 293 U. S., at 130, it is stated in the minority opinion:

> "But this Court is neither called upon, nor can it without impropriety, discuss mere questions of state law. * * * It is not our function to suggest to State Courts how they shall interpret their own laws; theirs is the duty of deciding such matters; ours requires forbearance from tendering advice in that regard."

More recently this Court, in *R. R. Commission of Texas* v. *Pullman Co.*, 312 U. S. 496, at 501, 85 L. Ed. 971 (a case involving the validity of a ruling by the Commission that all persons acting as Pullman conductors must hold that rank, which ruling had been enjoined below), in remanding the case to the District Court to be retained therein pending institution of an action in State Court for determination therein of the questions of State law and policy, held:

> "But no matter how seasoned the judgment of the District Court may be, it cannot escape being a forecast rather than a determination. The last word [on interpretation of State law] belongs neither to us nor to the District Court but to the

> Supreme Court of Texas. * * * Few public interests have a higher claim upon the discretion of a federal chancellor than the avoidance of needless friction with state policies, whether the policy relates to * * * the administration of a specialized scheme for liquidating embarrassed business enterprises, Pennsylvania v. Williams, 294 U. S. 176, 79 L. ed. 841, 55 S. Ct. 380, 96 A. L. R. 1166; or the final authority of a state court to interpret doubtful regulatory laws of the state, Gilchrist v. Interborough Rapid Transit Co., 279 U. S. 159, 73 L. ed. 652, * * * These cases reflect a doctrine of abstention appropriate to our federal system whereby the federal courts, 'exercising a wise discretion,' restrain their authority because of "scrupulous regard for the rightful independence of the state governments' and for the smooth working of the federal judiciary."

Those above quoted words of Justice Frankfurter were prophetic for the case at-bar. This company and Investors Syndicate were carefully supervised and controlled by the States, just as are insurance companies. The attempted intervention of the Federal Courts and the S. E. C. with the disposition of this insolvent company has created a needless friction and an unnecessary interference with State policies. The fact that these respondents are here and are joined as *amici curiae* by other States holding a Fidelity deposit, and by still other States with similar depository laws, but having no Fidelity deposit, in their efforts to prevent encroachment of Federal powers upon what they deem and believe to be within the province of the States and State officials and State Courts, speaks for itself as to the creation of friction and interference with State Court authority to interpret State laws. The needlessness thereof we leave for the determination of this Court.

Other decisions of this Court upon the same subject matter are:

*Kline* v. *Burke Construction Co.*, 260 U. S. 226, at 235:

> "The rank and authority of the (Federal and State) courts are equal but both courts cannot possess or control the same thing at the same time, and any attempt to do so would result in unseeming conflict. The rule, therefore, that the court first acquiring jurisdiction shall proceed without interference from a court of the other jurisdiction is a rule of right and law based upon necessity. • • •"

*Toucey* v. *New York Life Insurance Co.*, (Nov. 17, 1941), 10 Law Week 4025, 86 L. Ed. 107:

> "The act of 1793 expresses the desire of Congress to avoid friction between the Federal Government and the States resulting from the intrusion of Federal authority into the orderly functioning of a State's judicial process.
>
> "We must be scrupulous in our regard for the limits within which Congress has confined the authority of the courts of its own creation. Taylor v. Carroll, 20 How. 582, 597. The legislation of Congress, in organizing the judicial powers of the United States, exhibits much circumspection in avoiding occasions for placing the tribunals of the states and of the Union in any collision."

This Court unanimously followed the holding and decision of the *Pullman* case in the case of *Chicago* v. *Fieldcrest Dairies, Inc.*, April 27, 1942, 10 Law Week 4039, 86 L. Ed. 888, and remanded the case to the District Court to be retained pending decision by the State Court in a suit to be brought therein. This decision involved an interpretation of milk ordinance of the City of Chicago and the

question of its unconstitutionality and invalidity, and it was there held:

> "We are of the opinion that the procedure which we followed in the Pullman case should be followed here. Illinois has the final say as to the meaning of the ordinance in question."

It was again held that even this Court would be merely making a forecast as to what would be the ultimate decision of the Supreme Court of Illinois, and the Federal Court was being asked to decide an issue that might be displaced the next day by State adjudication, and the Court stated:

> "The delicacy in that issue and an appropriate regard 'for the rightful independence for state governments' (Beal v. Missouri Pacific R. Co., 312 U. S. 45-50) re-emphasizes that it is a wise and permissible policy for the Federal Chancellor to stay his hand in absence of an authoritative and controlling determination by the state tribunals. * * * In this case that discretion calls for a remission of the parties to the State courts which alone can give a definite answer to the major questions posed. Plainly they constitute the more appropriate forum for the trial of those issues. Considerations of delay, inconvenience and cost to the parties which have been urged upon us do not call for a different result, for we are here concerned with a much larger issue as to the appropriate relationship between Federal and State authorities functioning as a harmonious whole."

In the case at bar, we believe the words of Judge Soper, of the Fourth Circuit Court of Appeals, in deciding the instant question below, are pertinent (R. 262):

> "Moreover, it must be borne in mind that the rights of the contract holders in the several States

> must be determined in each instance by the local statutes, and that these statutes must be interpreted in accordance with the decisions of the State Courts. It is no reflection upon the Federal Court to suggest that the State Courts of the fifteen States are better qualified to construe and apply their own laws."

Petitioners contend that the District Court should interpret and decide the depository laws of each of the fifteen States and is better qualified to do so than the highest Courts of each of those States. Regardless of personal qualifications, such a decision would be, as this Court states, merely a forecast and not a finality, and could be set aside by each of those State Courts "the next day."

## Necessity of an Interpretation of State Depository Statutes

While in a few States there has been a partial interpretation of the depository laws of those States, yet in a majority of the States there has not been a decision and interpretation by the Court of last resort of their depository laws, and particularly is this true of the depository laws in connection with annuity companies such as Fidelity, most of which were enacted within the last two decades. Furthermore an interpretation as to who are the specific beneficiaries of the trust created by the State deposit, and those who are to be included in the class of beneficiaries, and those who are to be excluded, has not been made in any of the State Courts; yet this will have to be decided by a legal interpretation of the depository law of each State by some competent Court.

It must be kept continually in mind that with a few exceptions, there are insufficient funds on deposit in each State to pay off in full the rightful claims of the contract holders in that State. Therefore, the question is pre-

sented as to how each State shall distribute the funds deposited therein among those entitled thereto. If one group receives more, *a fortiori* others will receive less. And respondents contend that the distribution and decision as to the exact beneficiaries, and the exact proportion of his claim that each contract holder as such beneficiary will receive, are purely problems for the Courts of each State; that is, an interpretation and decision as to their own depository law should be made by the Courts of the State enacting that law, as admittedly, the laws of each of the fifteen depository States are dissimilar.

In each State it will be necessary for a court to determine whether anyone who ever paid money into Fidelity on a contract will be included in the class of beneficiaries meant to be included within the terms of the depository statute; or whether those who were currently paying in on April 4, 1941 (when its accounts were frozen by Auditor Sims), are to be included, even though they had not then acquired a reserve or cash surrender value under the terms of their contract; or whether only those who by their contracts had acquired a reserve or a cash surrender value thereon shall be exclusively entitled to participation.

Again, as between those found entitled to share in the deposit of each State, the local Court must decide whether they are to share on the basis of cash surrender, or reserve value, or amount paid in, as under each basis different amounts will be allocated depending on the length of time the contract was in effect.

Also, in Illinois, Kansas, Indiana, and to a lesser degree, Ohio, deposits were made in those States in compliance with certain existing statutes, and at other times contracts were sold when no depository requirements were in effect. Surely, the question as to which of the contract holders in each of these States shall participate

in the funds deposited therein is a problem solely for the Courts of each of those States to determine.

Of necessity, since there are fifteen different depository States in the case at bar, each with its own depository statute or requirement, there will have to be a decision on the State law of each of those States, expressly based upon its own laws and upon its own decided cases. *And this is admitted in the S. E. C. brief, p. 45.* The basis of participation in each State's deposited fund is purely *a local problem of law within each State*, as apparently by the deposit law of each State, except West Virginia, only domestic contract holders are entitled to share in the distribution of the deposited funds.

The peculiar provisions of the West Virginia depository statute (Code 33-9-3) are set out elsewhere herein. It is apparently provided that when "by the laws of any other State" a deposit is required equal to or greater than that required in West Virginia (100% of cash liability), then there shall be no deposit required in West Virginia for the contract holders of such a State. This apparently applies to Alabama, Delaware, Iowa, Kentucky, Maryland, Missouri, Tennessee, Wisconsin, and probably to Illinois. In any event, the percent of deposit to the liabilities (percentage of solvency) in each of those States is such that there is every probability their contract holders will receive more from their deposited securities than will those who participate in the West Virginia deposited fund (See Appendix, Part IX). In this event, they would then apparently have no claim over against the West Virginia fund; but this is a question that can be finally settled only by the State Court in West Virginia.

It may well be contended that the West Virginia depository law (Code 33-9-3) apparently means that those above named States actually have no right ever to participate in the West Virginia deposited fund because they had a

100% deposit law of their own (Code 33-9-3), and no deposit was made in West Virginia for their contract holders; and the West Virginia statute provides they "shall not be entitled to the benefit" of the West Virginia fund "except so much of such deposit as may be made to complete the total amount required by this article where the law of any other State requires a lesser amount." By that it is not meant to say that if they are not paid in full, they are not entitled to participate in any undeposited funds in West Virginia, because they probably are. But their right to participate in the West Virginia deposited securities is surely a question that must be decided by a West Virginia State Court.

If, therefore, these 100% deposit law States will in no event participate in the deposited funds in West Virginia, then in each of the above named depository States, *there must be an entirely autonomous* proceeding in the Courts thereof. Only their own contract holders, as determined by their own Courts, can share in their deposited securities, and only on the basis that the local Court therein determines; and they can have no claim against the funds in West Virginia, and the contract holders in no other State have any claim against their fund, the deposit being exclusively for the benefit of domestic creditors.

The brief of the S. E. C. states, page 39, that the West Virginia deposit "is clearly intended to secure *all* creditors" and that West Virginia authorities contend that the West Virginia creditors have a preferential interest in their deposit. Both statements are equally inaccurate. The West Virginia respondents contend that the depository law of West Virginia needs judicial interpretation, and that *only* the State Courts of West Virginia can render a *binding and final* decision upon the questions that necessarily arise from its construction; and that

West Virginia officials *can* be guided only by such a State Court decision, and *will* be bound absolutely to abide by it. The West Virginia respondents have no other contentions or intentions in this regard.

That the Courts in West Virginia will make a just decision upon these questions, and will give no undue preference to West Virginia claimants, can be readily discerned from *Brunner* v. *York Bridge Co.*, 78 W. Va. 702, 90 S. E. 233.

On pages 58 and 59 of their brief, petitioners repeatedly refer to rights of "out-of-state-creditors" to participation in local deposits, other than West Virginia, and the S. E. C. brief makes similar refernces and claims for non-resident claimants (pp. 29 and 41); and particularly reference is made to such rights in States as Iowa and Wisconsin, where there is purported to be a surplus of assets. And petitioners claim that all contract holders would be compelled to go into such State Courts to present their claims to any such surpluses that may exist in any State.

But no cases are cited in support of these contentions, and the decided cases are unanimously opposed to petitioners' position.

The decided cases are unanimous in holding that after satisfaction of the claims of domestic creditors, such deposited funds are not subject to the claims of, or attachment by, foreign or "out-of-state" creditors, and any surplus or balance remaining must be returned to the West Virginia Receivers, that is the domiciliary receivers, to be a part of the general assets of the company there, but not a part of the domiciliary deposit fund. *Rollo; Assignee*, v. *Andes Ins. Co.*, 23 Gratt. 509, 29 R. C. L. 108, Sec. 82; *People* v. *Granite State Provident Ass'n*, 161 N. Y. 402, 55 N. E. 1053; *Lewis* v. *American S. & L. Ass'n.*, 98 Wis. 203, 73 N. W. 793; *In re Stoddard* (N. Y.), 144 N. E. 484.

And the domiciliary receivers may pursue and collect such surpluses by ancillary proceedings.

Therefore, the theoretical problems raised by petitioners cannot and will not arise.

We therefore submit that should the West Virginia depository statute be interpreted as above suggested, that at least nine States will have autonomous proceedings in their own State Courts; and that there cannot possibly be any necessity why any of the depository States, including those nine, should be compelled to have their own laws interpreted in a District Court in another State (West Virginia), and be made parties to, and a part of, a proceeding in which they can have no possible interest, and where the other parties thereto can have no possible interest in them; and that in any event, *the problems of law arising by reason of the deposits made in each State as required by the laws and statutes thereof, should be decided only by the State Courts of each State.* And no reasons have been advanced in opposition briefs for a holding to the contrary.

## III

## THE STATE OFFICIALS OF THE FIFTEEN DEPOSITORY STATES, ACTING UNDER THE GUIDANCE OF EACH OF THEIR RESPECTIVE STATE COURTS AND REPRESENTED BY THEIR ATTORNEY GENERALS AND OTHER PROPER ATTORNEYS, HAVE NOT BEEN SHOWN NOT TO BETTER FITTED TO LIQUIDATE AND DISTRIBUTE THE DEPOSITED SECURITIES THAN IS THE TRUSTEE.

Presuming, as we have throughout this brief, and as the S. E. C. has in its brief admitted (pp. 18 and 43), that

Fidelity cannot be rehabilitated and that liquidation must ensue, there is then presented the single remaining issue, namely, *Who should liquidate the securities held by the depository States, and who should distribute the proceeds thereof to the contract holders?*

In this presumption we are following the opinion of the Circuit Court of Appeals below in no longer entertaining any idea "that illusory hopes of reorganization may be entertained" (R. 2[illegible]), and viewing the situation in the light of that which the Court below so ably stated, "We think it is our duty to review the situation realistically, and when this is done, there appears to be no reasonable hope of a reorganization of the business as a going concern, but only the immediate need of a liquidation of the company's assets for the benefit of the contract holders. Obviously there will be nothing left for the stockholders" (R. 259).

The Court below, in deciding upon this particular issue (R. 262), stated:

> "It has not been and cannot be reasonably contended that the interests of the well secured creditors will be advanced *by interfering with the state officials in the prompt liquidation and distribution of the securities* in their hands. The liquidation in every state in which deposits were made will be subject to the supervision of established governmental departments, as well qualified for the business as the trustee in bankruptcy. There is every reason to believe that the liquidation under their supervision will proceed without needless expense in a careful and expeditious manner so as to save as much as possible for the contract holders. Certainly it would be unjust and unreasonable to delay the satisfaction of their claims in order that illusory hopes of reorganization may be entertained."

In commenting upon the same issue, under similar circumstances, the Second Circuit Court of Appeals in *In the Matter of Paloma Estates, Inc.*, 126 F. (2d) 72; certiorari denied December 8, 1942, 11 Law Week 3172, stated:

> "Though there might be a reorganization under Chap. X of the Bankruptcy Act, the value of the debtor's property is so small compared to the amount due on the first mortgage that under *Case* v. *Los Angeles Lumber Products Co., Ltd.*, 308 U. S. 106; only the certificate holders represented by the appellee trustees could have any equity to be preserved. See also, *Consolidated Rock Products Company* v. *Dubois*, 312 U. S. 510. There is nothing to indicate that their interests would or could be better protected in the district court. There *would be increased expense and delay* without any compensating advantages. And it would be inequitable to subject the certificate holders to such expense in time and money when their security, already inadequate, is being well applied to subserve their best interests in the prior state court proceedings. See, *Chapman Bros. Co.* v. *Security-First National Bank*, 111 F. (2) 86."

Respondents contend that the State Court proceedings will not only afford a more rapid means of liquidation and distribution, but a less expensive method. That Chapter X proceedings are slow and lengthy, and are usually very expensive, is recognized not only by the Courts, but by the writers on this subject. (See brief of Attorney General of New York in the *Marine Harbor* case.) In New York Legislative Document No. 87, on the legislative investigation of the Prudence Bonds issue, it is stated: "In a reorganization under 77B, the proceedings were complicated and extended over a long period of time." Specific large fees paid in cases to many parties at the expense of certificate holders were cited.

Mr. Benjamin Wham, writing in 25 Virginia Law R. 389, states at 391:

> "Very likely [Chapter X] proceedings will take more time due to the increased numbers of petitioners, and it may be more expensive, and at least there will be more petitions for compensation * *. The provisions with reference to allowance of fees and costs are designed to invite active participation of the creditors and stockholders. It sounds like 'come and get it'."

Mr. James N. Rosenberg, also writing in 25 Virginia Law R. at 157-8 states:

> "The subject of expenses of administration gives food for thought * * *. The Chandler Act opens a new door. Designed to democratize the proceedings and encourage investors' participation, it permits the Court to compensate even those who submit mere suggestions or objections * * *. The flood gates are now open."

In 52 Harvard Law R. 1349 at 1350 it is stated that "the Chandler Act, subordinating the desire to minimize expense to the ideal of universal protection * * presages an increase in the costs of reorganization," and in note 8, citing the hearings before the House Committee of the Judiciary on HR-6439, 75th Congress, 1st Sess., p. 368, states that in the ordinary case it has been estimated the services of a competent disinterested trustee would cost $25,000 a year with a like sum for counsel. At p. 1353 the article states: "Care must be exercised lest the affairs of a hopelessly insolvent concern be dissipated in futile attempts at reorganization."

**Liquidation Should Promptly Ensue, and in the State Court Proceedings**

In *Reading Hotel Corp.* v. *Protective Committee*, 89 F. (2d) at 53, the Court held that the creditors had the

right to foreclose when their lien exceeded the value of the property securing it, and there was no equity for stockholders, and held that the possibility of creating an equity for stockholders in years to come is not sufficient interest to permit them to compel the lienholders to wait.

This Court in *Tennessee Publishing Co.* v. *American National Bank*, 299 U. S. 18, 81 L. Ed. 13 held: "However honest in its efforts the debtor may be and however sincere its motives, the District Court is not bound to clog its docket with visionary or impractical schemes for resuscitation."

And Mr. Justice Douglas, speaking in 42 Yale Law J. at 592: "It seems moreover, not too extravagant to hope that bankruptcy can be viewed against the background of the condition with which it deals; that long term planning for the many separate problems can be made • • •. Such planning leads directly to a consideration of division of control and responsibility *between State and nation* as respects these various problems and of allocating or dividing between the two bankruptcy power as an incident of that control."

In 27 Cornell Law Q. at 373, Mr. Ganard Glenn, author of books on liquidation, states: "If a concern cannot be reorganized the older remedy of liquidation • • • remains and always will." And as Judge Jerome Frank stated at p. 349, speaking then as head of the S. E. C. and for it, "It would be amazing, therefore, if our construction were right every time."

And in *First Nat. Bank* v. *Flershem*, 299 U. S. 504, at 515, 78 L. Ed. 46, this Court in Note 7 stated, that all the cases in which it has exercised its power to aid in reorganization upon the ground of insolvency dealt with insurance or other public utilities where continued opera-

tion of the property and preservation of its unity seemed to be required in the public interest.

And in *International Shoe Co.* v. *Pinkus*, 278 U. S. 261, 73 L. Ed. 321, this Court held:

> "The general rule is that an intention wholly to exclude State action will not be implied unless when fairly interpreted an Act of Congress is plainly in conflict with State regulation in the same subject."

And in the *Marine Harbor* case (supra) this Court held:

> "While the pendency of prior proceedings in state or federal courts does not bar the filing of a petition under Ch. X (Sec. 256), Congress in effect directed the bankruptcy courts not to approve petitions under Ch. X in such cases unless it appeared that the interest of creditors and stockholders would not be best subserved in the prior proceedings. And it put the *burden on the petitioner* to make that showing."

In *California Prune, etc. Co.* v. *Cate American Co.*, 60 F. 2d 789 at 790, the Court held: "The Act itself discloses it was the intent of the Legislature to provide a procedure peculiarly adapted to the State Courts of California; and in view of many of the provisions of the Act, it would be difficult if not impossible to harmonize it with federal law and procedure."

And as Mr. John Gerdes says in 18 N. Y. U. Law Q. Rev. at 313: "Paternalistic reorganization of insolvent companies by governmental agencies runs counter to fundamental and deep-seated American concepts."

On Oct. 22, 1942, Waring J. (D. C. S. C.) held in *In re Unity Life Ins. Co.*, 11 Law Week 2361: "If the

Court comes to the conclusion that there is no chance of a reorganization and that liquidation is the only expectation, the petition should be refused."

In its brief in the *Marine Harbor* case in which it appeared, the S. E. C. stated, p. 13: "Chapter X is designed for the *permanent rehabilitation* of a corporate debtor while safeguarding the interests of security holders." See also p. 27.

In Chapter X proceedings it is necessary to have fees paid the trustee, the trustee's attorney, the debtor's attorney, committees of creditors and stockholders, and their attorneys, appraisers, masters and probably a few others.

In the instant State Court proceedings there were no creditors protective, or stockholders, committees, no appraisers or masters, no debtors' attorney in most proceedings, and salaried State officials instituted the majority of the proceedings, by their salaried Attorney Generals.

Therefore, liquidation and distribution can better be had in the State Court proceedings, under the guidance of the State officials.

**The Salutary Safeguards of Chapter X**

We have earlier herein set forth the reason for our belief that under the ruling in the *Marine Harbor Properties* case it is unnecessary to determine whether the salutary safeguards of Chapter X exist in the prior pending State Court proceedings; that which is hereinafter stated is in answer to the brief of petitioners and upon the presumption that this Court *may* hold that it is necessary to investigate these safeguards.

Under the decision of this Court in *Securities and Exchange Commission* v. *United States Realty Co.*, 310 U.

S. 434, 84 L. Ed. 1293, and the dissenting opinion of Judge Frank in the *Marine Harbor* case, 125 F. 2d 296, there are apparently three main safeguards contained in Chapter X, namely, that the S. E. C. be permitted a supervisory power in the proceedings; that a fair and equitable, and at the same time feasible, plan be presented; and that the creditors be given full information before they are required to act with reference to the reorganization.

However, petitioners have suggested a number of other and further reasons why Chapter X proceedings are superior to those in State Courts, which are: (1) the proceedings in the State Courts are not under any reorganization statutes; (2) the creditors should be protected from the old management group; (3) the need of advisory reports on the feasibility of a plan, and whether it is fair and equitable; (4) a report to the creditors under Section 175 giving the creditors information as to their interests; (5) an independent study by the S. E. C. to exclude collusive programs; (6) a requirement that the plan be approved by the Court prior to submission to the creditors; (7) an independent appraisal of the assets of the Debtor by the S. E. C.; (8) the retaining of jurisdiction by the reorganization Court; (9) the lack of jurisdiction in any State Court to review all of the liabilities of Fidelity or appraise all its assets; (10) Fidelity's business can only be administered in the Bankruptcy Court because it has national jurisdiction; (11) the creditors in State Court will be at the mercy of those having charge of the several State proceedings; (12) several State Courts threatened distribution without a judicial determination of the rights and interests of out of State creditors to participate in the local deposited assets; (13) the rights of participation among and between the contract holders must be judicially determined; (14) there will be balances remaining in several States after

their local contract holders are paid from their deposited funds, and all of the contract holders will have to file a claim against these remaining balances.

Discussing these problems in the above order, with reference to the three main safeguards, Congress enacted Section 25 of the Investment Company Act of 1940 and Section 29 of that Act, dealing with reorganization and bankruptcy of face-amount certificate companies, after enacting Chapter X. As above discussed, the S. E. C. may participate in these proceedings, may render advisory reports therein, and has such supervisory control as the Congress believed and determined it was necessary that it should have over such companies.

The terms "fair" and "equitable" and "feasible" are words of art, which mean that any plan adopted must comply with the full priorities rule of the *Boyd* case. *Case* v. *Los Angeles Lumber Products Co.*, 308 U. S. at 115. It is agreed by petitioners (Brief p. 40), as well as respondents, that the stockholders have no further interest in the proceedings, even though this present controversy is and has been carried on and this present hearing had by virtue of the activities of the stockholders alone. In no State Court proceeding will the stockholders be given any more rights than they would have in the federal proceedings, and their activities in fighting the State Court proceedings indicate their knowledge of this. The deposited funds will be distributed to the contract holders rightfully entitled thereto, under the State laws as interpreted by the State Courts. Since the only plan is liquidation and distribution, there is apparently no need for any further determination of its fairness and feasibility.

The State Court Receivers and the authorities in the various States were in communication with the contract holders until that was further prohibited by injunction by

the District Court. The thousands of letters written by contract holders to the State Court Receivers (R. 320), the mass meeting of the contract holders at Wheeling (R. 398-403), and the fact that one receivership suit was brought as early as 1938, together with the fact that contract holders are and have been represented by committees in the instant proceedings, all indicates contract holders are alert, and have been receiving information concerning the affairs of the company.

Of course, Section 167(5) of Chapter X provides that the Trustee "shall, at earliest date possible, prepare and submit a brief statement of his investigation of the property, liabilities, and financial condition of the debtor, the operation of its business and the desirability of the continuance thereof, in such form and manner as the judge may direct, to the creditors," etc.

On October 10, 1941, the Trustee prepared and submitted to the Court a partial report under this section, and on April 13, 1942, a further partial report. To date, these reports have not been submitted in any form to the contract holders.

No criticism is meant or implied in the Trustee's action in this regard. The reports are extremely voluminous, contain many charts, and detailed financial statements. They undoubtedly took much time to prepare, even though the Trustee had available the data prepared by the State Court Receivers.

And it would appear, since the Trustee has not done so, that it was impossible to boil this material down into a reasonably sized statement for the contract holders. Also, the expense of printing and mailing such a statement to over 80,000 persons is for practical purposes, prohibitive, and we believe the Trustee's judgment in not doing it was sound.

But, this very section, 167(5), is supposed to be one of the main safeguards found in Chapter X which will not be present in any State Court proceeding, and therefore a substantial reason for preferring Chapter X proceedings, that is, that the creditors may act only upon an informed knowledge.

This safeguard, therefore, is not one to be considered by this Court, because since the Trustee has not given this information to the contract holders in the year and a half it has held office, presumably, for the sound reasons above stated, it will not do so in the future.

Therefore, the contract holders will have at least as informed an opinion in State Court proceedings as they would under Chapter X proceedings.

With reference to the points raised by petitioners:

(1) It is true that State proceedings are not under reorganization statutes, but any necessary reorganization could have been performed in the proceedings instituted in State Courts, either by virtue of the statute under which they were brought, or by virtue of the general equity powers of the Courts. Let it be remembered that with few exceptions every insolvent insurance corporation in the United States has been reorganized through these same statutory and general equity proceedings in the State Courts by State officials.

However, each of the State statutes or their general laws do have a provision for *liquidation* of the State deposits. The respondents here believe the question of reorganization statutes is beside the point, and since they have adequate legal machinery for liquidation and distribution, that is all that is necessary in this case.

(2) It seems anomolous that the petitioners who here represent the old management group of the company would, on page 52 of their brief state: "Chapter X was

designed to provide safeguards for the creditors and stockholders against the superior knowledge and advantageous position of the management." The State officials are and were doing that very thing, the West Virginia Receivers having discharged the management group immediately after taking charge of the company under their appointment, and it is that management group so discharged which instituted the Chapter X proceedings. It is now argued that the proceedings are needed to protect the contract holders from that management group who raise that question.

(3) The management group of the company represented by petitioners can, under Section 25(b) of the Investment Company Act, request an advisory report of the S. E. C. in State Court proceedings, which they claim is needed.

(4) We will later discuss the report to creditors showing their interest, but it can be here stated that that has been done already in West Virginia and some of the other State Court proceedings, and to date has not been attempted in the Federal proceedings.

(5) The S. E. C. not only has made a study for several years of this particular company, but has submitted a printed book to Congress (Ex. 6) containing the results of that investigation, and has submitted other reports to Congress containing information upon investment companies, including face-amount certificate companies generally. Any collusive or fraudulent program in State Court proceedings can be enjoined by the S. E. C. under Section 25(c) of the Investment Company Act.

(6) It is again anomolous for the Debtor to raise, on page 53 and on page 57, the question that there is no *statute* which requires the plan to be submitted to the creditors only after it has been approved in State Courts. A petition was filed in the West Virginia State Court

praying that no plan of reorganization be submitted to the contract holders without notice and right to be heard by that petitioner and her counsel. (Ex. 70-b of the case at bar, not printed).

The Circuit Court of Kanawha County, on May 26, 1941, after a hearing on that petition, in section 2 of that order (Ex. 70-c, not printed), ordered:

> "The form and manner of submission by such Receivers to contract holders of any plan of reorganization and rehabilitation of defendant, or any information concerning same, shall be submitted to this Court for approval before such submission, after notice thereof to petitioner and other contract holders who may at the time be parties to this suit, and after hearing upon such notice."*

Therefore, the question raised in this record by petitioners was fully answered for them in the State Court proceedings.

(7) Debtor's assets have been appraised by innumerable auditors and accountants prior to the institution of these proceedings by the Debtor, and at the request of the S. E. C., and have been and are before this Court in a number of financial statements.

(8) Petitioners contend on page 54 of their brief that Chapter X is superior to the prior State proceedings because "the reorganization court has jurisdiction to retain supervision for the purpose of seeing that the plan is fully and fairly carried out."

However, the Second Circuit Court of Appeals in *In re Flatbush Avenue-Nevins Street Corporation*, decided January 8, 1943, 11 L. W. 2544, opinion by Judge Jerome

*See also letter of Circuit Court Judge, Appendix Part VI.

Frank, holds that after the plan has been approved by the reorganization court it has no further jurisdiction in the matter, and that Congress did not intend the bankruptcy court, after approval of a plan under Chapter X, should "have power to remain a wet nurse to the reorganized company. A bankruptcy court cannot obtain that power merely by inserting a provision reserving jurisdiction."

The State Courts can retain jurisdiction of the proceedings before them as long as there is any necessity so to do, and the State authorities are required by their own laws to maintain supervision over these companies until the proceedings are finally ended by complete distribution.

(9) It is not true that no single State Court has jurisdiction of Fidelity to review all of its liabilities and appraise its assets. This is a part of the function of the Auditor of West Virginia, and he has done that, and the State Court Receivers prepared complete lists of the assets and liabilities and filed them in the West Virginia State Court proceedings, which were in turn filed by the Federal Trustee herein as part of its required reports.

(10) Petitioners' contention that Fidelity's business can only be administered in the Bankruptcy Court under Chapter X, is wholly without merit. Congress, in enacting Sec. 25 of the Investment Company Act specifically provided legislation for reorganization proceedings in Courts other than the Bankruptcy Court.

Also, the Securities Exchange Commission, in its report to Congress on the Study and Investigation of the Work, etc., of Protective and Reorganization Committees, Part VIII, at p. 309, states: "Large numbers of reorganizations do not come within the jurisdiction of the federal courts. *Some take place in state courts or under supervision of state agencies.* * * * We do not believe it

*feasible* to attempt to bring such reorganization completely under either judicial or administrative supervision by the federal government."

(11) While it may be true that in the State Court proceedings contract holders will be at the mercy of those in charge thereof, nevertheless those in charge are the State's officials, acting in their official capacity, and who were elected to their offices by those contract holders in their own States. We submit that those persons will be as careful of the rights of the contract holders in their States as would be a Federal corporate trustee, not selected by the creditors, but appointed by the District Court in a district many hundreds of miles from the location of the contract holders.

(12) It is true that the several States not only threaten but intend to distribute the assets held in those States, but it is not true that this is to be done wihout judicial proceedings. On the contrary, liquidation and distribution by the States will be made only in the State Courts thereof. Petitioners, as stated hereinbefore, failed to cite any authority whereby out of state creditors had any rights at all in the funds deposited in trust in a State for the benefit of the contract holders of that State alone, and therefore, there is no question which can arise under any decided authority concerning the rights of such out of State persons.

(13) As hereinbefore stated, it will be necessary for the Courts of each State to determine among the contract holders of their own State who, under the depository laws of that State, are entitled to participate in the deposited assets, and naturally this question will have to be decided before a distribution is made. The petitioners and the S. E. C. advance no reasons against the argument hereinbefore made that the determination of such

questions of State law should only be made by the State Courts in the State which enacted those laws.

(14) We have hereinbefore set forth the cases which hold that balances or surpluses remaining after distribution in any State must be returned to the West Virginia Receivers, who are the domiciliary Receivers, and that no out of State contract holder has any right to go into the Courts of the State having such surplus or balance and make any claim thereto. See also 29 R. C. L. 108 s. 82. The petitioners cite no authority to substantiate their position.

**Proceedings Subsequent to Circuit Court of Appeals Decision.**

As shown by the record, shortly after the decision of the Circuit Court of Appeals (R. 276, 282) the State officials, their Attorney Generals, State Court Receivers, and their attorneys, for each of the fifteen depository States, met in Charleston, West Virginia, for the purpose of exchanging information and to work out cooperatively their mutual problems, particularly the problems of liquidation and distribution.

Counsel for most of the parties herein, except the S. E. C., had a conference before Judge John J. Parker, of the Court below, prepared and had entered by the Court, on July 22, 1942. (R. 268), an agreed order permitting the servicing of the deposited funds by the State officials, permitting the necessary liquidation of securities and providing for the sending out and receiving of proofs of claims by the State authorities, and other administrative work looking to the future distribution of the assets.

Wisconsin, prior to the institution of the Chapter X proceedings, had sent out its proofs of claim and had received and filed them. In the Tennessee proceedings, a report on claims has been filed with the Court.

Under the order of July 22, the State authorities worked out a uniform proof of claim to be sent the contract holders and have laid tentative plans for liquidation of the deposited securities, under the advice of State officials, so that there will not be competition between the States in the liquidation, and in order to obtain the highest price possible for the deposited assets. At the conference in Charleston, Auditor Sims of West Virginia was chosen as head of an advisory committee for the liquidation of securities, and has requested the heads of the Insurance Departments of eleven other States to act with him on that advisory committee, and has received replies from each of them that they will act in such capacity. Those persons are the Security Commissioners or heads of the Departments of Insurance of the States of Connecticut, Illinois, Indiana, Massachusetts, Michigan, Virginia, Minnesota, Missouri, New York, Ohio and Pennsylvania.

Certainly this advisory group, acting together with those State officials who are directly in charge of the securities departments and who have direct supervision over the liquidation of Fidelity, and acting under the judicial guidance of the respective State Courts in fifteen States, are equally as capable as is the Federal Trustee of liquidating the deposited securities.

The uniform proof of claim tentatively agreed upon for use in this case has been used by West Virginia and Missouri, and is in the process of being used in Ohio, Delaware, Tennessee and Indiana, and other States have only refrained from continuation of their administrative procedure in this respect pending the final determination of this case by this Court. Copies of these uniform proofs of claims are contained in the Appendix, Part VIII. They answer many of the questions which petitioners have raised and, together with the letter of transmittal to the contract holders, were worked out with the cooperation and aid of the attorneys for the Federal Trustee.

They give to the contract holders all of the information concerning his claim which the company has in its books and records. The West Virginia Receivers, acting under the Auditor of West Virginia, as well as in their own capacity, have sent out proofs of claim, over sixteen thousand in number, to all of the West Virginia contract holders and to all of the contract holders in those States which have no deposit and which will look primarily to the West Virginia fund for payment. The work of receiving the returns and filing them has been practically completed at this time.

As will be noted, the form is very simple, and mechanically arranged so that one typing fills in the blank spaces on both the letter of transmittal and the proofs of claim.

All information as to the claim is filled in by the official sending out the claims, including the amounts paid in by the contract holder, the cash surrender value, loan amount (if any), and net cash surrender value; the contract owner need only fill in his residence at the time of the purchase, and his residence on April 11, 1941, the date of receivership, verify the correctness of the claim, swear to it, and return it. Missouri has sent out and received its proofs of claim on these forms, and has used the tentatively agreed upon form for proof of claim over against West Virginia.

Each of the depository States is expected to do as has Missouri,—send out two proofs of claim forms, filled in with the information from the company's books as to the respective claim of that contract holder, both of which claims will be returned to the officials of the State sending them out. One form will be a proof of claim against the deposited fund in that State; the other will constitute a claim over against the West Virginia fund in the event the contract holder does not receive full payment in his own State and has a claim against the assets in West Vir-

ginia. These will later be sent en masse by the State officials in the various States, together with the amount and percent of total claim each contract holder receives from his domestic deposit, to the Receivers in West Virginia, who will accept them as proper proofs of claim, subject, of course, to a decision as to their rights against the assets in West Virginia, which must be determined by the West Virginia State Court. Surpluses, if any exist in any State, will be sent to the West Virginia Receivers.

No objection to this procedure has been made by any contract holder, and it apparently resolves all of the questions which petitioners and the S. E. C. attorneys have raised as to the necessity of filing many proofs of claim.

Therefore, the remaining matters to be performed in the State proceedings are extremely limited. Those States which have not completed sending out and receiving proofs of claim will proceed to do so. The various State officials and Receivers acting cooperatively together, but under the jurisdiction of their own State Courts, and with the advice and help of the insurance Commissioners of many States, will liquidate the deposited securities. *After the necessary legal determination* as to amount each contract holder shall receive is had in each of the State Courts, a distribution of the proceeds will be made to those properly entitled thereto. West Virginia will be in charge of all contract holders in that State, and in all States having no deposit; all contract holders not receiving the full amount of their claim from their respective State deposits will settle all of their problems in this regard in the West Virginia State Court by claims over against the West Virginia assets.

It is, therefore, respectfully submitted that the officials of the fifteen States acting under their State laws and under the guidance of their Courts are capable of per-

forming these acts, as shown by their actions in the past; that they are capable of working cooperatively together in the future for the best interests of the contract holders, and will do so, and should be permitted so to do.

## IV

## REPLY BY THE ACTING ATTORNEY GENERAL OF WEST VIRGINIA TO THE S. E. C. BRIEF

While all other parts of this brief have been written jointly on behalf of the West Virginia respondents, this particular reply (Part IV of this brief) is submitted solely by the Acting Attorney General of West Virginia.

The S. E. C. brief, page 30, states that the Circuit Court of Appeals below, in reaching its conclusion that the State proceedings better subserve the interests of Fidelity's contract holders, failed to give due weight to a number of factors which establish the superiority of Chapter X proceedings.

The first of those factors is that it is peculiarly salutary to utilize the provisions of Chapter X to investigate and prosecute possible causes of action for the benefit of the Debtor's estate (p. 31), and that problems of venue and jurisdiction are major obstacles to civil suits at the instance of all State officials but those in West Virginia, and these latter are unsuited to the purpose.

This question of suitability of the West Virginia respondents will be discussed first.

Certain statements are made on page 33 of the S. E. C. brief that counsel for the West Virginia Receivers were Fidelity's regular counsel and one of them was under indictment. The Solicitor General's office has advised

that these statements were inadvertently placed in the brief, are not supported by the record, and it is the desire of that office that the statements be disregarded and not considered by this Court.

The correct fact is that counsel for the West Virginia Receivers had been local (R. 1184) and special (R. 1167) counsel for Fidelity in recent years. The Circuit Court of Kanawha County, West Virginia, by proper order entered on April 11, 1941, authorized and approved employment of the counsel for the West Virginia Receivers, after a petition therefor had been presented by the Receivers (R. 574). That employment had the full consent and approval of the Auditor of West Virginia, and was undertaken at the request of, and with the express consent, recommendation and approval of, the then Attorney General of West Virginia.

The S. E. C. brief states that the position of the West Virginia respondents does not give promise of as adequate a prosecution of possible causes of action, against Fidelity's management (Brief, p. 33) for the benefit of the contract holders, as would be made by the Trustee, because one Receiver is a law associate of, a former Fidelity director, Mr. Arthur B. Koontz.

In fairness to Mr. Koontz and that Receiver, this separate answer is made. Mr. Koontz was a director, with one qualifying share of stock placed in his name (R. 1166), who lived and practiced law in Charleston, West Virginia (R. 1134), two hundred miles from Wheeling, where the home office of Fidelity was located. Mr. Koontz is a respected member of the bar in West Virginia.

In answer to a question as to whether he would feel free and unhampered in any attempt that might be made to recover funds due Fidelity from any party whom it was deemed advisable to proceed against (R. 1195), Mr.

Koontz stated that if his firm could not go ahead and prosecute the suit fully, they would step aside and the Attorney General would appoint somebody to go ahead and prosecute the suit, but that he, Mr. Koontz, could think of no personal or business association "that would retard any affirmative action on our part." (R. 1198.)

The propriety of the appointment of that same West Virginia Receiver was raised in the District Court, and because thereof, the Judge of the Circuit Court of Kanawha County, West Virginia, who made that appointment, wrote a letter to the District Judge, giving his reasons therefor, and explaining the entire situation. This letter is in evidence, and is set out in the Appendix Part VI.

The same issue was raised in the Circuit Court of Appeals below, which considered the matter, and stated in its opinion (R. 262):

> "• • • and the suggestion is made that the state court receivers would not be likely to proceed diligently against the directors if an investigation should disclose the existence of some liability on their part to the corporation's creditors. No specific facts are set out in this respect, but if such facts exist and the necessity for a proceeding against the directors should arise, we have no reason to suppose that the state court will not do its full duty in the premises."

Not only does the evidence fail to disclose any such probable causes of action, but the Trustee, although it has held office for one and two-thirds years, has yet to make any report of any purported liability or cause of action against any officer or director; nor has the S. E. C. produced any such evidence in this case, although it investigated the affairs of the company for over four years;

and no contract holder has made any such claim or instituted any action thereon.

The statements in the S. E. C. brief overlook the fact that the S. E. C. and the Trustee are supporting in this Court the position and contentions of the Debtor, and that it is the officials who comprised Fidelity's former management, who were instrumental in instituting the Chapter X proceedings, who testified in the District Court in Debtor's behalf, who have opposed Auditor Sims and the West Virginia State Court proceedings, and who are carrying on this present controversy against the respondents. There are no reasons given why the West Virginia respondents would not properly perform their required duties in the premises equally as well as the Trustee and the S. E. C., *if* there were proper need to act against those persons.

Also, Mr. H. Isaiah Smith, one of the two West Virginia State Court Receivers, and a respondent herein, has been employed by the Trustee ever since its appointment, as the active executive head and agent of the Trustee in charge of Fidelity's affairs at its home office in Wheeling.

The testimony of Auditor Sims indicates the fearless and impersonal manner in which he has heretofore discharged his duties concerning Fidelity; the Attorney General of West Virginia is counsel for the Auditor, the plaintiff in the West Virginia State Court proceedings, and the writer feels it will be presumed that whoever that Attorney General may be at the time action is needed will fully perform his duties in the premises.

Disregarding the question of suitability, there are several reasons why the contentions of the S. E. C. are without merit.

The alleged causes of action are those by contract

holders against the former management or directors, and there is no claim alleged to exist against such persons on account of the Debtor or its estate alone. For this reason, neither the Receivers nor the Trustee would have any right to represent contract holders in any such suits, but if such rights of action existed, they would be solely the property of the individual contract holders.

Next, the Supreme Court of Appeals of West Virginia, on October 14, 1941, decided, in the case of *Inter-Ocean Casualty Co.* v. *Leccony Smokeless Fuel Co. et al.*, 17 S. E. (2d) 51, at 53-4:

> "* * * In this state it is well settled that the creditor of a monied corporation cannot maintain an action at law against the directors thereof for simply nonfeasance of duty to the corporation or fraud in its management or mismanagement in the disposition of the money or property of the corporation in the absence of an active intent to deceive or defraud the plaintiff. *Zinn* v. *Mendel*, 9 W. Va. 580."

And there is no evidence in this case of any "active intent to deceive or defraud" the contract holders by any director or officer of Fidelity.

Apparently it is the S. E. C. contention that such rights of action could be brought in the reorganization proceedings, particularly if the causes of action inured to the benefit of the Debtor. There is no citation of authority in support of this position. However, in the Circuit Courts of Appeals of the 3rd, 5th, 7th, 8th and 9th Circuits, actions such as those contemplated were instituted against directors on behalf of the debtor in 77-B proceedings, and in every circuit it was held that such causes of action were not a proper part of reorganization

proceedings, and for jurisdictional reasons could not be instituted in the Federal Court. Those cases are:

*Bovay* v. *Byllesby & Co.*, 88 F. (2d) 990 (5th C. C. A.).

*In re Standard Gas & Electric Co.*, 119 F. (2d) 658 (3rd C. C. A.).

*Brockett* v. *Winkle Terra Cotta Co.*, 81 F. (2d) 949 (8th C. C. A.).

*Thompson* v. *Terminal Shares, Inc.*, 104 F. (2d) 652 (8th C. C. A.).

*U. S.* v. *Tacoma Oriental S. S. Co.*, 86 F. (2d) 363 (9th C. C. A.).

*In re Prima Co.*, 98 F. (2d) 952 (7th C. C. A.); Certiorari denied 305 U. S. 658.

The theory upon which these cases were brought was that the right of action against the directors or former management was an asset of the debtor over which the Court had jurisdiction, and that it was in reality an *in rem* proceeding.

The *Bovay* case was one wherein it was claimed the directors falsely obtained money from the debtor. The Court held it was an action *in personam* and process served outside the territorial limits of the District Court was ineffective to acquire jurisdiction, as the claim was not *in rem*.

In the *Standard Gas* case, of the same nature, the same ruling was made, and also that a suit against a resident director would not lie, as there was no diversity of citizenship; that the Court's jurisdiction outside its own territory was only *in rem*, and therefore no valid service could be had on non-resident directors.

In the *Brockett* case it was held that charges of mis-

conduct against officers and directors can not properly be determined in a reorganization proceeding.

There is only one director within the territorial jurisdiction of the District Court in this case, only a few in West Virginia, and the rest live elsewhere. Such a suit, even if there were grounds, would fail in the Chapter X proceedings.

Again disregarding the question of suitability, if the causes of action belonged to the Debtor and it was necessary to institute suit thereon outside of the Chapter X proceedings, either within or without the State of West Virginia, then the State Court Receivers, themselves or through ancillary receivers, would legally be as capable of prosecuting these causes of action as would the Trustee, for in either event the Trustee or Receivers would have to proceed in the proper State or Federal Court wherein the particular defendant lived in order to obtain proper service upon that defendant for an *in personam* action.

Therefore, no substantial reasons, grounds, or decided cases have been advanced in the S. E. C. brief that would sustain petitioners' burden of proving the superiority of Chapter X proceedings over those already pending in the State Courts.

## V

## THE JURISDICTION OF THIS COURT HAS BEEN IMPROPERLY INVOKED

The petitioners herein were without valid right or authority to file Debtor's petition for writ of certiorari.

It is submitted that the Trustee is not and should not be concerned with the merits of a petition filed under Chapter

X of the Bankruptcy Act, or with its dismissal, and has no right to partake in the controversies thereon.

*Loomis* v. *Gila County*, 103 F. (2d) 312, Certiorari denied, 307 U. S. 643.

The S. E. C., who is named a respondent herein, but who is in substance a petitioner, "may not appeal or file any petition for appeal in any such proceeding." Sec. 208, Ch. X.

It is further submitted that since the District Court held invalid the original corporate meeting of June 3, 1941, purporting to authorize the filing of the Debtor's petition on June 6, 1941, that thereafter there was no valid or lawful corporate meeting validly ratifying the filing of the petition, nor could there have been such lawful and valid ratification, since the directors were forbidden to serve by Section 9(a) of the Investment Company Act, they having been enjoined in the Detroit suit in 1938 (Ex. 6, p. 257), and no exemption having been granted them upon their application to the S. E. C. therefor (Ex. 88, R. 766-67).

Also, it is submitted that since there was no corporate meeting authorizing the filing of the petition for writ of certiorari in the case at bar, the purported authorization acted upon was invalid and improper. Further, the actions of those officers and directors, who purported to act in Debtor's behalf throughout these proceedings, were such that the Debtor's petition was not filed in good faith within the generality of the meaning of that term. Sec. 146, Chap. X.

Lastly, since the only assets within the territorial jurisdiction of the District Court were those deposited with the *State* of West Virginia, and since under the Eleventh Amendment the Court has no control or jurisdiction over those funds, and since the principal place of

business of Fidelity was in Wheeling, in the *Northern* Federal District of West Virginia, these proceedings in the Southern District of West Virginia must fail for lack of proper venue under Sec. 128 of Ch. X.

The facts upon which the above contentions are based, and the citations of law and authorities which sustain these assertions, and the arguments thereon, are fully set forth in the West Virginia Respondents' Brief In Opposition To The Petition For Writ of Certiorari:

Realizing that the broad aspects of Section 146, particularly Sections 146(3) and (4), are now before this Court, and that the decision herein in all probability will not be based upon the more narrow issues under this jurisdictional heading, we, therefore, do not herein repeat those facts, citations of law and argument thereon, but refer the Court, if it deems the matter of importance, to our brief in opposition to certiorari, pages 5 to 10, 11 to 13, 17 to 26, 41 to 52, and 55-56 inclusive.

## CONCLUSION

For the reasons set forth above, your respondents, the Auditor and ex officio Insurance Commissioner of West Virginia, and the West Virginia Receivers, hereby respectfully submit that the decision, holding and judgment of the Circuit Court of Appeals should be affirmed.

Respectfully submitted,

IRA J. PARTLOW,
*Acting Attorney General of West Virginia,*

KOONTZ & KOONTZ,
*Attorneys for West Virginia State Court Receivers,*

J. CAMPBELL PALMER, III,
*Of Attorneys for West Virginia State Court Receivers,*

*Counsel for the West Virginia Respondents*

# APPENDIX

## PART I

## STATUTES INVOLVED

### United States Statutes

The following sections of Chapter X of the Bankruptcy Act:

Sec. 130. Every petition shall state . . .

(7) The specific facts showing the need for relief under this chapter and why adequate relief cannot be obtained under Chapter XI of this Act.

Sec. 141. Upon the filing of a petition by a debtor, the judge shall enter an order approving the petition, if satisfied that it complies with the requirements of this chapter and has been filed in good faith, or dismissing it if not so satisfied.

Sec. 144. (Printed page 64 of Petitioners' Brief).

Sec. 146. (Printed page 64 of Petitioners' Brief).

### West Virginia Statutes

The following sections of the Code of West Virginia, Ch. ---, Art. ---, Sec. ---:

12-5-2:

Treasurer Custodian of Securities; Charges to Companies for Care, etc., of Securities.—The treasurer of this state, unless otherwise expressly provided by law, shall be custodian of all securities belonging to the state of West Virginia or by law required to be deposited with the state or held in legal custody by the state, and all departments of this state, commissioners or agents of the

state, who hold any such securities, shall transfer and deliver the same to the state treasurer to be kept and held by him as legal custodian thereof until released in the manner provided by law.

The board of public works may by formal order of record fix fair and reasonable charges for the care, custody, exchange and substitution of securities deposited by insurance companies and companies issuing annuity contracts, and such charges shall be collected from such companies by the state treasurer and by him deposited in the state fund general revenue: Provided, however, That no such charge shall be made against any such company having securities of the par value of less than three hundred thousand dollars deposited hereunder.

### Constitutional Provisions Involved

Constitution of the United States:

Eleventh Amendment.—The judicial power of the United States shall not be construed to extend to any suit in law or equity, commenced or prosecuted against one of the United States by Citizens of another State, or by Citizens or Subjects of any Foreign State.

## PART II

## STATUTES DISCUSSED

### United States Statutes

The following chapters and section of the Bankruptcy Act:

Chapter II.—The Bankruptcy Court shall have the power to:

Sec. 2a(5). Authorize the business of bankrupts to be conducted for limited periods by receivers, the marshals, or trustees, if necessary in the best interests of the es-

tates, and allow such officers additional compensation for such services, as provided in section 48 of this Act.

Sec. 2a(7). Cause the estates of bankrupts to be collected, reduced to money and distributed, and determine controversies in relation thereto, except as herein otherwise provided, and determine and liquidate all inchoate or vested interests of the bankrupt's spouse in the property of any estate, whenever under the applicable laws of the State, creditors are empowered to compel such spouse to accept a money satisfaction for such interest.

Chapter X—

Sec. 236. If no plan is proposed within the time fixed or extended by the judge, or if no plan proposed is approved by the judge and no further time is granted for the proposal of a plan, or if no plan approved by the judge is accepted within the time fixed or extended by the judge, or if confirmation of the plan is refused, or if a confirmed plan is not consummated, the judge shall—

Sec. 236(1). Where the petition was filed under section 127 of this Act, enter an order dismissing the proceeding under this chapter and directing that the bankruptcy be proceeded with pursuant to the provisions of this Act; or

Sec. 236(2). Where the petition was filed under section 128 of this Act, after hearing upon notice to the debtor, stockholders, creditors, indenture trustees, and such other persons as the judge may designate, enter an order either adjudging the debtor a bankrupt and directing that bankruptcy be proceeded with pursuant to the provisions of this Act, or dismissing the proceeding under this chapter, as in the opinion of the judge may be in the interests of the creditors and stockholders.

Former Section 77-B—

(c) Upon approving the petition or answer or at any time thereafter, the judge, in addition to the jurisdiction

and powers elsewhere in this section conferred upon him, * * * (8) if a plan of reorganization is not proposed or accepted within such reasonable period as the judge may fix, or, if proposed and accepted, is not confirmed, may, after hearing, whether the proceeding be voluntary or involuntary, either extend such period or dismiss the proceeding under this section or, except in the case of a railroad or other public utility or of a debtor which has not been found by the judge to be insolvent, direct the estate to be liquidated, or direct the trustee or trustees to liquidate the estate, appointing a trustee or trustees if none shall previously have been appointed, as the interests of the creditors and stockholders may equitably require; * * *"

11 U. S. C. A. 203(i) (1)—

The court shall confirm the proposal if satisfied that (1) it included an equitable and feasible method of liquidation for secured creditors and of financial rehabilitation for the farmer; * * *

The following sections of the Investment Company Act of 1940:

Sec. 3 (a) (2)—

When used in this title, "investment company" means any issuer which—

* * *

(2) is engaged or proposes to engage in the business of issuing face-amount certificates of the installment type, or has been engaged in such business and has any such certificate outstanding; * * *.

Sec. 9 (a) (2)—

It shall be unlawful for any of the following persons to serve or act in the capacity of officer, director, member

of an advisory board, investment adviser, or depositor of any registered investment company, or principal underwriter for any registered open-end company, registered unit investment trust, or registered face-amount certificate company:

* * *

(2) any person who, by reason of any misconduct, is permanently or temporarily enjoined by order, judgment, or decree of any court of competent jurisdiction from acting as an underwriter, broker, dealer, or investment adviser, or as an affiliated person, salesman, or employee of any investment company, bank, or insurance company, or from engaging in or continuing any conduct or practice in connection with any such activity or in connection with the purchase or sale of any security; * * *

Sec. 25 (b)—

The Commission is authorized, if so requested, prior to any solicitation of security holders with respect to any plan of reorganization, by any registered investment company which is, or any of the securities of which are, the subject of or is a participant in any such plan or if so requested by the holders of 25 per centum of any class of its outstanding securities, to render an advisory report in respect of the fairness of any such plan and its effect upon any class or classes of security holders. In such event any registered investment company, in respect of which the Commission shall have rendered any such advisory report, shall mail promptly a copy of such advisory report to all its security holders affected by any such plan: *Provided*, That such advisory report shall have been received by it at least forty-eight hours (not including Sundays and holidays) before final action is taken in relation to such plan at any meeting of security holders called to act in relation thereto, or any adjournment of any such meeting, or if no meeting be called,

then prior to the final date of acceptance of such plan by security holders. In respect of securities not registered as to ownership, in lieu of mailing a copy of such advisory report, such registered company shall publish promptly a statement of the existence of such advisory report in a newspaper of general circulation in its principal place of business and shall make available copies of such advisory report upon request. Notwithstanding the provision of this section the Commission shall not render such advisory report although so requested by any such investment company or such security holders if the fairness or feasibility of said plan is in issue in any proceeding pending in any court of competent jurisdiction unless such plan is submitted to the Commission for that purpose by such court.

Sec. 25 (c)—

Any district court of the United States in the State of incorporation of a registered investment company or any such court for the district in which such company maintains its principal place of business is authorized to enjoin the consummation of any plan of reorganization of such registered investment company upon proceedings instituted by the Commission (which is authorized so to proceed upon behalf of security holders of such registered company, or any class thereof); if such court shall determine any such plan to be grossly unfair or to constitute gross misconduct or gross abuse of trust on the part of the officers, directors, or investment advisors of such registered company or other sponsors of such plan.

Sec. 25 (d)—(Printed page 68 Petitioners' Brief).

Sec. 29 (a) and (2), (3)—(Printed page 66 Petitioners' Brief).

Sec. 29 (b)—

Section 44 of said Act of July 1, 1898, as amended, is

amended by adding at the end of subdivision (a) thereof the following sentence:

"If the bankrupt is a face-amount certificate company, as defined in section 4 of the Investment Company Act of 1940, the Court alone shall make the appointment; but the court shall not make such appointment without first notifying the Securities and Exchange Commission and giving it an opportunity to be heard."

## West Virginia Statutes

The following sections of the Code of West Virginia, Ch. ___, Art. ___, Sec. ___:

12-5-1:

Securities Defined.—The term "securities" when used in this article shall include all bonds, securities, debentures, notes or other evidences of indebtedness.

12-5-6:

When Notes Deemed Securities; Appraisal.—(a) Whenever, by statute of this state, any public official, board, commission or department of this state is charged with the approval of securities required as collateral for the deposit of public or other funds, or required to be deposited with the state treasurer, or an investment of capital or surplus or a reserve or other fund is required to be maintained consisting of designated securities deposited with the state treasurer, such securities shall, at the discretion of such public official, board, commission or department, be deemed to include and mean notes executed by the person or corporation required to make such deposit and made payable to the state of West Virginia upon demand, in the event of insolvency or default by such person or corporation, for the benefit of those for whom such securities are deposited, when such notes are secured * * *.

33-1-1:

Insurance Commissioner; Expenses; Assistants.—The auditor of this State shall continue to be the insurance commissioner of this State. * * *

~~33-2-15~~: (Printed page 69 Petitioners' Brief).
33-9-1: (Printed page 70 Petitioners' Brief).
33-9-3: (Printed pages 70-72 Petitioners' Brief).
33-9-10: (Printed page 72 Petitioners' Brief).

### Constitutional Provisions Discussed

Constitution of West Virginia:

Article VI, Section 35.—The State of West Virginia shall never be made defendant in any court of law or equity, except the State of West Virginia including any subdivision thereof, or any municipality therein, or any officer, agent, or employee thereof, may be made defendant in any garnishment or attachment proceeding, as garnishee or suggestee.

## PART III

## DIGEST OF DEPOSITORY LAWS AND TRUST INDENTURES OF THE FIFTEEN STATES WHERE FIDELITY MADE A DEPOSIT AND STATUS OF STATE COURT PROCEEDINGS PENDING THEREIN

### Alabama

By order of State Securities Commission, on July 9, 1938, Fidelity securities were admitted to record in the Registry of Qualified Securities, upon compliance with the following terms: To enter into a bond in the amount of $5,000.00 and a trust indenture. The trust indenture was entered into with the First National Bank of Montgomery, Alabama, for a two year period from March 23,

1939, and provided for a deposit and assignment of securities acceptable to the Securities Commission, "to be equal at all times to $110.00 for every $100.00 of liability under its certificates;" and further provided a method for valuing the deposited securities, provided that the deposit should be "in trust for the holders of all contracts issued and to be issued to residents of Alabama, and shall constitute a separate and exclusive trust fund," and shall not be available to general creditors of the investment company; that a full and complete assignment of all right, title and interest in the deposited securities should be made to the depository; and provided that upon a default by the company the securities were to be delivered to the State Securities Commission, upon written demand therefor, to be administered and liquidated for the benefit of Alabama investors; and in no event should the deposit be less than the liabilities of the company upon all contracts and certificates issued to residents of the State of Alabama.

Default was claimed, and the securities were transferred to the Securities Commission, who is holding them and acting under the advice and counsel of the Attorney General pending the outcome of these proceedings.

## Delaware

Statutes require the company to obtain a license to do business in the State, and as a condition prerequisite, deposit with the State Banking Commissioner "in trust for the benefit of its contract holders resident in the State of Delaware, approved securities in the amount of $100,000.00," and that the Commissioner, if he shall determine that the deposit is insufficient for the protection of contract holders, having regard for its obligations, may demand forthwith additional securities not in excess of

100% of its obligations to contract holders resident in said State.

The securities have been retained by the Banking Commissioner in Delaware, who is acting under the advice of the Attorney General, pending the determination of these proceedings.

**Illinois**

Prior to July 7, 1931, there was no depository law in Illinois. On that date legislation was enacted requiring a deposit of not less than $50,000.00 of securities in which life insurance companies could invest, and the deposited fund at no time to be less than issuer's current contract liability on all contracts thereafter sold in the State of Illinois. The State Treasurer holds the deposit as custodian for the Secretary of State. By a later enactment, the Illinois Security Law was amended to provide that the deposit be maintained to cover all contract liability on contracts theretofore or thereafter sold in Illinois, and the Secretary of State is given the right, in the event of insolvency, to liquidate the deposited securities, under the supervision of a court of competent jurisdiction, and the procedural steps to be taken in that regard by the Secretary of State are stated.

The Secretary of State instituted a proceeding in the Circuit Court of Sangamon County, Illinois, under the Illinois Security Act, for the preservation and maintenance of the securities on deposit. The Attorney General of Illinois represents the Secretary of State in those proceedings.

**Indiana**

Prior to April 1, 1935, when the Legislature repealed it, the law of Indiana required a deposit of approved securities with the Auditor of not less than $25,000.00,

and at all times a sum "equal to the amount of its liabilities to citizens of this State." The benefits of this law were preserved by a trust agreement, and the deposited amount retained in Indiana. There was no depository requirement until April 1, 1939, when the Indiana Securities Commission adopted and promulgated a rule requiring annuity companies to deposit, in trust, with the Auditor, a bank or other approved depository, for the benefit of the holders of such contracts, securities valued at not less than $10,000.00, and at no time less than the amount of the issuer's current contract liability on all outstanding contracts sold in the State.

A receiver was appointed for the assets of the defendant by the Marion Superior Court, in the suit of *Kernel, plaintiff*, v. *Fidelity Assurance Association*, but the bank with whom the assets are deposited in trust has retained possession of the deposited securities pending the outcome of these proceedings, and the Securities Commission of Indiana is being advised by the Attorney General, who is acting in the premises.

## Iowa

Statute requires a certificate of authority from Commissioner of Insurance, and as a prerequisite a bond approved by him guaranteeing the faithful performance of all contracts entered into, or deposit of approved securities of $25,000.00, and a deposit equal in amount to all its liabilities to persons residing within said State.

On May 19, 1941, Charles R. Fischer, Insurance Commissioner, was appointed receiver of the assets by the District Court of Polk County, in the case of *Shaw* v. *Fidelity Assurance Association*, and in said action, by order of said Court, title to said securities was vested in said Insurance Commissioner.

## Kansas

The State Securities Law required a deposit of $50,000.00 of approved securities in an amount between 100% and 120% of the liability on all outstanding contracts sold and held in said State. The 1929 Legislature of Kansas reenacted the Securities Law, but omitted the provision for making the deposit, and consequently no deposit was made in Kansas for contracts sold subsequent to that date.

Receivership proceedings were instituted in State Court in Kansas by the Attorney General on behalf of the Commissioner of Securities Division of the State Corporation Commission and an ancillary receiver was therein appointed.

## Kentucky

In compliance with the requirements of the Securities Department, a deposit was made with the Farmers Deposit Bank of Frankfort, Kentucky, under agreement dated November 5, 1935. The securities deposited were to be held for the Securities Commissioner and were to be in the initial sum of $10,000.00, and in addition such amounts as might be necessary for the specific purpose of maturing and paying the amounts due under the terms of the Income Reserve Contract Series D. By agreement dated November 2, 1938, and with the approval of the Director of the Division of Securities of the State of Kentucky, the agreement was modified so as to provide for deposit of securities to cover the cash liability of the Association on all series of contracts issued by it and held by residents of the State of Kentucky.

Application for appointment of receivers was made in the Circuit Court of Franklin County, in the suit of *Lusk* v. *Fidelity Assurance Association*, no turn over has been made to them, and the Attorney General of Kentucky is acting in the premises.

## Missouri

By approval of the Securities Commissioner of Missouri, a deposit was made with the Wheeling Dollar Savings & Trust Company, of Wheeling, West Virginia, for the benefit of holders of contracts of Fidelity residing in Missouri, the deposit to be held for the Securities Commissioner, in an amount equal to 100% of the cash liabilities to Missouri contract holders.

On May 28, 1941, in the cause of "*State ex info. Roy McKittrick, Attorney General, ex rel. Russell Maloney, Commissioner of Securities*, v. *Fidelity Assurance Association*," a receiver was appointed, who later demanded a return of the deposit physically to the State of Missouri, which the District Court granted, where the securities are now being held under order of the Circuit Court of Cole County.

## Maryland

The laws of Maryland require companies such as Fidelity to assign to and deposit with the Insurance Commissioner, in trust as security for the holders of contracts sold in Maryland, certain securities of value not less than $25,000.00, and in addition an amount equal to the aggregate contract liability of the company under all contracts theretofore or thereafter sold in the State.

No receiver was appointed in Maryland, but the Circuit Court of Baltimore City, an equity court, in the exercise of its ordinary chancery powers assumed jurisdiction of, and supervision over, the administration of said trust, and the Insurance Commissioner of Maryland, as Trustee, is now subject to the orders of said Court.

## Ohio

Prior to April 21, 1939, in Ohio, as a prerequisite to doing business, annuity companies were required to deposit

with the Treasurer $100,000.00 as security for all claims of residents of Ohio against such company for judgments and decrees. Those laws were amended on the above date, so as to require Fidelity to maintain a deposit with the Supervisor of Bond and Investment Companies, of approved securities in an amount equal to the cash surrender value on all contracts thereafter entered into with persons resident in the State. Beginning March 1, 1940, if the company then or thereafter was licensed to do business, it was required to deposit securities to the full cash surrender value of all contracts held by residents of this State, including those issued prior to the effective date of the Act. Fidelity quit doing business in Ohio prior to March 1, 1940, and therefore never became subject to the retroactive provisions of the statute.

On April 17, 1941, John A. Lloyd, Superintendent of Insurance and Supervisor of Bond Investment Companies, was appointed Receiver of the assets of Fidelity situate in Ohio, including the deposited securities, by the Common Pleas Court of Franklin County, Ohio, in his suit against the company, instituted on his behalf by the Attorney General of Ohio.

**Pennsylvania**

The Pennsylvania Securities Commission must license incoming corporations, and as a prerequisite, a deposit of $100,000.00 as security for the fulfillment of its contracts theretofore or thereafter sold to residents of Pennsylvania.

In the latter part of 1939, an agreement between Fidelity and Pennsylvania Securities Commission was entered into, whereby Fidelity was given a temporary license to do business in the State upon its promise to make a deposit with the Securities Commission of $100,000 as security for the fulfillment of its contracts, sold during

the existence of the temporary license, and a deposit of approximately $132,000.00 was made under said agreement.

On April 17, 1941, receivers were appointed by the United States District Court for the Eastern District of Pennsylvania, in the equity cause entitled *Levy v. Fidelity Assurance Association*, and that Court required the Securities Commissioner in the Middle District of Pennsylvania to make a turn-over to those receivers of the securities deposited with that Commissioner. In June of 1942, this Court, upon request therefor, awarded approximately $11,000.00 to said receivers and their attorneys for their services, principally in retaining those securities in a proper bank vault.

Receivers were appointed in a similar suit instituted in the Western District of Pennsylvania, which receivers have in their possession approximately $32,000.00 of the general undeposited assets of the company. These receivers have agreed with West Virginia officials for a termination of their proceedings.

The Attorney General of Pennsylvania has tentatively agreed to cooperate with West Virginia officials to attempt to have the other Federal equity receivership terminated and the funds returned to the Pennsylvania Securities Commission.

**Tennessee**

The statute of March 10, 1939, required a deposit with the Commissioner of Insurance and Banking, for the benefit of holders of the contracts in that State, in an amount not less than $10,000.00 and in no event less than 100% of the issuer's cash liability on all outstanding contracts sold in Tennessee.

On April 21, 1941, in the Chancery Court for Davidson County, Tennessee, a general creditors' bill was brought

by *L. H. Brooks et al.* v. *Fidelity Assurance Association*, and the Treasurer of Tennessee, as the legal custodian of the securities deposited therein, was made a party to the cause and directed to retain the securities, and the Court found that the appointment of a receiver was unnecessary, the Attorney General representing the Treasurer therein.

### Virginia

In Virginia the Securities Division of the State Corporation Commission required Fidelity to post a bond of $25,000.00 as a condition precedent to doing business in the State, to which those doing business with the company could look, for payment of judgments obtained for fraudulent sales, failure to obey Virginia statutes, and other losses suffered by those who did business with Fidelity. In lieu of a surety on the bond, United States Government securities were deposited with a Richmond bank under a written agreement.

Alex W. Neal, Jr., was appointed receiver in the Circuit Court of the City of Richmond for said company, and has cooperated with the Securities Division. The above bond has expired, and the statute of limitations on claims thereunder will shortly expire, at which time the securities deposited as collateral to the bond will be turned over to the receiver, with the consent and approval of the Securities Division.

### West Virginia

Statutes Given in Full in Appendix, Parts I and II.

### Wisconsin

Under the laws of Wisconsin for the regulation of foreign building and loan associations, Fidelity was required to keep on deposit with the State Treasurer, in trust for the benefit and security of all its members (contract

holders) in said State, the sum of $500,000.00, to be held in trust until all contracts held by residents of said State had been fully performed and discharged, the securities to be approved by the Banking Commission. Whenever the Banking Commission should find that the liability of the issuer for contracts outstanding for persons residing in the State exceeded 90% of the deposit required above, the Commission may issue an order requiring the deposit of an additional sum, so that at all times the outstanding liabilities shall not exceed 90% of the deposited securities.

On April 14th, the Banking Commission, by the Attorney General of Wisconsin, filed its petition in the Circuit Court of Dane County, Wisconsin, for the purpose of having adjudged and decreed the title, possession and control of the assets, business and property of Fidelity located in Wisconsin to be vested in the Banking Commission; and an order was entered in May liquidating approximately $1,500,000.00 of the deposited securities, and authorizing the Banking Commission to study any plan for reinstatement of the defendant, and, if acceptable, to submit it to the Court for approval.

## PART IV

## "WEST VIRGINIA SOUND VALUE" FORMULA FOR VALUATION OF DEPOSITED SECURITIES

The Auditor and ex officio Insurance Commissioner of the State of West Virginia has prescribed a formula for the valuation of deposited securities. According to said formula

(1) Bonds and debentures that are not now in default of their interest or principal, and that have continued to pay interest, should be valued at par;

(2) All preferred and common stocks should be valued at the market;

(3) All mortgages, real estate and secured notes should be carried at book value until such time as an appraisal or offer for sale indicates the value to be less, at which time the value for each should be changed to the lesser figure;

(4) All securities that are actually in default of principal or interest, or that have paid principal or interest in the past three years by the sale of additional securities or solely by means of borrowing money for this purpose, without having earnings equal to the amount to offset the loan, should be carried at current market prices.

## PART V

## LETTER OF AUDITOR EDGAR B. SIMS OF MARCH 25, 1941

STATE OF WEST VIRGINIA
AUDITOR'S OFFICE
CHARLESTON

EDGAR B. SIMS — AUDITOR
INSURANCE COMMISSIONER

INSURANCE DEPARTMENT
HARLAN JUSTICE

March 25, 1941

Mr. Arthur B. Koontz
Attorney-at-Law
Charleston, West Virginia

Dear Sir:

Owing to the precarious condition of the Fidelity Assurance Association, inasmuch as the company has been poorly handled and the capital and surplus would seem to be entirely wiped out and, perhaps, reserves impaired somewhat if absolute market values are applied, I have been giving serious consideration to asking for a receiver

ship in the Circuit Court of Kanawha County as is provided under the special statute under which the company was originally organized.

However, before doing so I should like to explore the possibility of placing this company in trusteeship under 77B of the Federal Bankruptcy Act for the purpose of determining whether this company can be reorganized and put on a sound basis financially and under competent management.

Inasmuch as you have acted for this company in a legal capacity for several years, I would ask you to consider the observations made hereinbefore and advise me at your very earliest convenience what steps we should take in the premises. You, of course, are at liberty to consult the members of the staff of the Attorney General's office or the legal staff of the S. E. C., or both.

Please investigate this matter immediately as I feel that no time should be wasted in reaching a decision.

Very truly yours,

(Signed) EDGAR B. SIMS,
*State Auditor,*
*Insurance Commissioner.*

EBS:MB

## PART VI

## LETTER OF JULIAN F. BOUCHELLE, JUDGE OF THE CIRCUIT COURT OF KANAWHA COUNTY, WEST VIRGINIA, TO BEN MOORE, JUDGE OF THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF WEST VIRGINIA

STATE OF WEST VIRGINIA
THIRTEENTH JUDICIAL CIRCUIT
CHARLESTON

September 19, 1941.

JULIAN F. BOUCHELLE
JUDGE

Honorable Ben Moore, Judge
United States District Court
Charleston, W. Va.

My dear Judge Moore:

I noticed in this morning's Gazette a statement attributed to you questioning the propriety of the appointment of Mr. Ross B. Thomas as co-receiver of the Fidelity Assurance Association by this court. I feel that you should be fully advised as to the circumstances which motivated my action in appointing Mr. Thomas as co-receiver with Mr. H. Isaiah Smith.

When application was made to me for the appointment of receivers under the West Virginia statute, there were present Messrs. W. W. Goldsmith and P. D. Koontz of the firm of Koontz & Koontz, Ira J. Partlow, Assistant Attorney General of West Virginia, and Auditor Edgar B. Sims in person, and upon their presentation of the

facts, and particularly the fact of Mr. Thomas' connection and intimate knowledge of the complicated affairs of the company, (which was later confirmed when I had made further investigation into the case), and with express consent of the auditor and the attorney general's office, I appointed the two above named persons as co-receivers.

Shortly thereafter I called Messrs. W. W. Goldsmith and P. D. Koontz to my office and explained to them that I would not place Mr. Thomas upon a salary as co-receiver, but would allow Mr. H. Isaiah Smith a monthly salary of $500.00 as receiver, and the firm of Koontz & Koontz a like sum as counsel for the receiver. I felt that upon the information given me and the knowledge I obtained that no one was better qualified to advise and act with Mr. Smith as receiver than Mr. Thomas. I indicated plainly to Messrs. Goldsmith and Koontz that this situation would continue only during the period of attempted reorganization, and which period I insisted should not be long-drawn out; and that if reorganization was found impossible and the time of liquidation reached, that I would give recognition to the representatives of the contract holders in the matter of receivership from that point on, and that Mr. Thomas would not be retained.

Counsel of this city representing some of the contract holders had conferences with me during the time the case was in this court, and I advised them of the foregoing and assured them that not only would they be notified but that they would be fully advised with upon the matter of reorganization; and that if and when the case became one of liquidation, I would give favorable consideration to recommendations by a substantial number of the contract holders in the receivership.

I feel that this explanation is due in fairness to Mr. Thomas and the firm of Koontz & Koontz, and, as pre-

viously stated, to acquaint you with my actions and intentions in this case.

Very truly yours,

JFB:SB (Signed) J. F. BOUCHELLE.

CC: Honorable Clarence W. Meadows
Honorable Edgar B. Sims
Messrs. Koontz & Koontz, Attorneys.

## PART VII

## SAMPLES OF UNIFORM PROOFS OF CLAIM AND LETTER OF TRANSMITTAL TO CONTRACT HOLDERS, TENTATIVELY AGREED TO BY DEPOSITORY STATES, AND ALREADY USED BY WEST VIRGINIA AND MISSOURI

H. ISAIAH SMITH and ROSS B. THOMAS, Receivers for FIDELITY ASSURANCE ASSOCIATION and Agents of Edgar B. Sims, Auditor and ex-officio Insurance Commissioner of West Virginia

FIDELITY BUILDING
WHEELING, W. VA.

The matter of Fidelity Assurance Association is now pending on an appeal to the Supreme Court of the United States. The United States Circuit Court of Appeals for the Fourth Judicial Circuit, on June 16, 1942, reversed the lower court and held that the reorganization proceeding pending therein should be dismissed. The appeal will determine whether the matter will be proceeded with in Federal Court or whether liquidation will ensue under the supervision and control of the various state officials who have under their authority and control the assets deposited in their state.

Pending the appeal, the Fourth Circuit Court of Appeals, by order of July 22, 1942, has permitted each proper state official or state court, having jurisdiction to make plans for future distribution of the funds under their control, supervision or jurisdiction. It is therefore necessary to ascertain the claims against the company, and the claims against each state deposit. Should it finally be held that the Federal Court has sole jurisdiction of the proceedings, all proofs of claim received will be turned over to the proper officials thereof.

Your contract account is set out below as shown by the company's books, as of April 11, 1941, the date of receivership. Enclosed is a proof of claim which must be completed by you and sworn to before a Notary Public, whose seal must be used, and returned in the enclosed envelope. If the figures are incorrect in any particular, insert

the correct figures, stating in writing your reasons therefor. *Payments received from you after April 4, 1941, are kept in a separate escrow fund, of which you have previously received notice.*

Serial No. , upon which

monthly payments of $ each have been made;

on which the cash surrender value as of April 11, 1941 was $

less contract loan and accrued interest to April 11, 1941 of $

or a net cash value as of April 11, 1941 of $

Your contract must accompany your return of claim. It is suggested you use registered mail with return receipt requested. This return must be filed before , 1942 and is being sent under order of Edgar B. Sims, Auditor and ex-officio Insurance Commissioner of the State of West Virginia.

Very truly yours,

H. ISAIAH SMITH and ROSS B. THOMAS.
Receivers and Agents

[18]This is the uniform form of the letter of transmittal sent by State officials and receivers to the contract holders. All of the blank spaces are typed in before the letter is mailed.

---

IN RE: FIDELITY ASSURANCE ASSOCIATION
(formerly Fidelity Investment Association)[19]

PROOF OF CLAIM OF

Filed with H. Isaiah Smith and Ross B. Thomas, West Virginia State Court Receivers, as such, and as agents of Edgar B. Sims, Auditor and ex-officio Insurance Commissioner of the State of West Virginia, against said Company generally, pursuant to a proper and lawful administrative order of the said Edgar B. Sims, Auditor and ex-officio Insurance Commissioner, issued on the 17th day of August, 1942.

STATE OF )
COUNTY OF )

Personally appeared before me, the undersigned authority, who, being by me first duly sworn, according to law, did depose and say that he is the owner of the contract hereinafter referred to, issued by Fidelity Investment Association, a West Virginia corporation; that he purchased said contract on the day of , 19 , in the State of , and that on the 11th day

of April, 1941, he was a resident of the State of ; that said Company is truly and justly indebted to him in accordance with the terms of said contract, the same being identified as

Serial No. , upon which

monthly payments of $ each have been made for application in accordance with the terms thereof, exclusive of payments made to the Company, its Receivers or Trustee subsequent to April 4, 1941, held by it or them in escrow subject to his order, of which he has heretofore been advised; that the cash surrender value thereof is $

less contract loan and accrued interest of $

or $

and that attached hereto and made a part hereof is the original contract above referred to.

(signature)

Taken, subscribed and sworn to before me this day of , 19
My commission expires on the day of , 19

(Notarial Seal) Notary Public

SEPARATE PROOF OF CLAIM MUST BE MADE IN RESPECT OF EACH CONTRACT HELD

[14] This is the uniform proof of claim form agreed upon, and the one used by the West Virginia respondents. All blank spaces but the place of residence of the contract holder when he purchased his contract, his signature with verification were filled in before mailing.

---

IN RE: FIDELITY ASSURANCE ASSOCIATION
(formerly Fidelity Investment Association)[15]

PROOF OF CLAIM OF

Filed with against said Company generally, and particularly against the assets thereof in the State of , pursuant to an order of , the of , dated the day of , 1942.

STATE OF )
COUNTY OF )

, Personally appeared before me, the undersigned authority, , who being by me first duly sworn according to law, did depose and say that he is the owner of the contract hereinafter referred to, issued by Fidelity Investment Association, a West Virginia corporation, that he purchased said con-

tract on the ..... day of ....., 19..., in the State of.....
..... and that on the 11th day of April, 1941, he was a resident of the State of.....; that said Company is truly and justly indebted to him in accordance with the terms of said contract, the same being identified as Serial No.....upon which an initial payment and .....monthly payments of $..... each have been made for application in accordance with the terms thereof, exclusive of payments made to the Company, its Receivers or Trustee subsequent to April 4, 1941, held by it or them in escrow subject to his order, of which he has heretofore been advised;
that the cash surrender value thereof is $.....

less contract loan and accrued interest of $.....

or $.....

and that attached hereto and made a part hereof is the original contract above referred to.

.....
(signature)

Taken, subscribed and sworn to before me this ..... day of ....., 19....
My commission expires on the ..... day of ....., 19....

.....
(NOTARIAL SEAL) Notary Public

SEPARATE PROOF OF CLAIM MUST BE MADE IN RESPECT OF EACH CONTRACT HELD

[18]This is the uniform proof of claim form used by States other than West Virginia. Again, all data is supplied before mailing. This claim will be filed by each State in its own proceedings.

---

IN RE: FIDELITY ASSURANCE ASSOCIATION
(formerly Fidelity Investment Association)[18]

PROOF OF CLAIM OF

.....

.....

.....

Filed with H. Isaiah Smith and Ross B. Thomas, West Virginia State Court Receivers, as such, and as agents of Edgar B. Sims, Auditor and ex-officio Insurance Commissioner of the State of West Virginia, against said Company generally, pursuant to a proper and lawful administrative order of the said Edgar B. Sims, Auditor and ex-officio Insurance Commissioner, issued on the 17th day of August, 1942.

STATE OF _____)

COUNTY OF _____)

Personally appeared before me, the undersigned authority, _____, who, being by me first duly sworn according to law, did depose and say that he is the owner of the contract hereinafter referred to, issued by Fidelity Investment Association, a West Virginia Corporation; that he purchased said contract on the _____ day of _____ 19__, in the State of _____, and that on the 11th day of April, 1941, he was a resident of the State of _____; and that said Company is truly and justly indebted to him in accordance with the terms of said contract, the same being identified as

Serial No. _____, upon which an initial payment and _____ monthly payments of $_____ each have been made for application in accordance with the terms thereof, exclusive of payments made to the Company, its Receivers or Trustee subsequent to April 4, 1941, held by it or them in escrow subject to his order, of which he has heretofore been advised;

that the cash surender value thereof is $_____

less contract loan and accrued interest of $_____

or $_____

_____
(signature)

Taken, subscribed and sworn to before me this _____ day of _____, 19__.

My commission expires on the _____ day of _____, 19__.

(NOTARIAL SEAL)

_____
Notary Public

SEPARATE PROOF OF CLAIM MUST BE MADE IN RESPECT OF EACH CONTRACT HELD

[18]This form, in a separate color, is also sent out by the States other than West Virginia, with the data filled in. It is returned to the State official sending it out. In the event there is later to be a claim over against the West Virginia funds, these claims will be sent en masse to West Virginia by the State official who receives them.

## PART VIII

## EXCERPTS FROM EXHIBIT 6, REPORT OF S. E. C. TO CONGRESS CONCERNING FACE-AMOUNT CERTIFICATE COMPANIES

Chapter III, Fidelity Assurance Association:

Page 88:

"For the period from 1927 to 1936 installment payments by certificate holders aggregated $49,230,000, of

which the Association applied on its books as income a total of $12,427,000, or 25.2%—25.2 cents of every $1 of installment payments. * * * Total commissions paid during the period 1927-1936 amounted to $9,308,000, a sum equal to 18.9% of total installment payments."

Page 96-7:

"The Association has followed a settled policy of investing its funds almost entirely in marketable securities, about 90% of which have consisted of bonds and notes. Investments in stocks have consisted principally of preferred stocks and have been, in the main, too small in amount to be of any importance. * * *

TABLE 26.—Classification of assets of Fidelity Investment Association, 1927-36 year-ends

(Amounts in thousands of dollars)

| Year | Cash | Bonds and Stocks* | Certificate Loans | Other Loans† | Real Estate | Other Assets | Total |
|---|---|---|---|---|---|---|---|
| 1927 | 217 | 11,851 | 2,369 | 206 | 66 | ---- | 14,799 |
| 1928 | 258 | 13,914 | 2,632 | 215 | 66 | ---- | 17,085 |
| 1929 | 258 | 14,595 | 4,360 | 417 | 62 | 59 | 20,151 |
| 1930 | 1,014 | 16,586 | 6,903 | 406 | 50 | 88 | 25,047 |
| 1931 | 770 | 18,373 | 8,918 | 896 | 50 | 129 | 29,136 |
| 1932 | 933 | 16,729 | 6,162 | 1,160 | 152 | 149 | 25,285 |
| 1933 | 547 | 18,331 | 3,951 | 1,130 | 152 | 174 | 24,285 |
| 1934 | 375 | 19,448 | 2,733 | 1,193 | 166 | 251 | 24,166 |
| 1935 | 789 | 21,838 | 2,548 | 1,033 | 264 | 306 | 26,778 |
| 1936 | 1,062 | 25,791 | 2,308 | 919 | 272 | 596 | 30,948 |
| | | | Percent of Total | | | | |
| 1927 | 1.5 | 80.0 | 16.0 | 2.0 | 0.5 | ---- | 100.00 |
| 1928 | 1.5 | 81.4 | 15.4 | 1.3 | .4 | ---- | 100.00 |
| 1929 | 1.3 | 74.4 | 21.6 | 2.1 | .3 | 0.3 | 100.00 |
| 1930 | 4.0 | 66.2 | 27.6 | 1.6 | .2 | .4 | 100.00 |
| 1931 | 2.6 | 63.1 | 30.6 | 3.1 | .2 | .4 | 100.00 |
| 1932 | 3.7 | 66.2 | 24.4 | 4.5 | .6 | .6 | 100.00 |
| 1933 | 2.3 | 75.5 | 16.3 | 4.6 | .6 | .7 | 100.00 |
| 1934 | 1.6 | 80.5 | 11.3 | 4.9 | .7 | 1.0 | 100.00 |
| 1935 | 3.0 | 81.6 | 9.5 | 3.9 | .9 | 1.1 | 100.00 |
| 1936 | 3.4 | 83.3 | 7.5 | 3.0 | .9 | 1.9 | 100.00 |

*Stocks generally were around 10 percent of the total.

†These consist of collateral and mortgage loans; also year-end balances of advances to National Sales Agency: 1927, $135,000; 1928, $140,000; 1929, $344,138; 1930, $538,000; 1931, $830,648; 1932, $982,179; 1933, $957,979; 1934, $1,048,402; 1935, $927,839; and 1936, $858,918."

Page 100:

"The Association apparently is able to continue in business and make a profit by appropriating to income a large part of the installment payments in the early months after the issuance of the certificates. * * *"

"For the period 1927-1937, net realized profits from the sale of investments aggregated $740,000 or about 50% of the total profits for the period."

Page 106:

*"The experience of purchasers of the Association's investment certificates appears to have been unsatisfac-*

*tory, as a whole* * * * But the group of certificate holders whose certificates lapsed or were surrendered before maturity—and this group constituted a large majority of all holders of terminated certificates—*suffered substantial losses*, both of capital and interest increment."

Pages 110-111:

"In other words—considering all certificates outstanding at any time during the period 1927-1936, and taking them by years—*from 91.38% to 93.14% of all terminations represented lapses or premature surrenders, leaving only from 6.86% to 8.62% of total terminations to be accounted for by terminations as the result of normal maturity.*"

Page 113:

"TABLE 29.—Comparative experience over a period of 10 years of an Income Reserve Contract, Series B certificate holder of Fidelity Investment Association and the holder of a United States Savings Bond.

| Year | Annual investments or installment payments (cumulative) | Comparative cumulative cash values at year-ends | | Excess of United States Savings Bonds over Fidelity Investment Association Certificates | Percent advantage over cumulative cash value of Fidelity's Certificates |
|---|---|---|---|---|---|
| | | United States Savings Bonds | Fidelity Investment Certificates | | |
| First | $ 100 | $ 101.33 | $ 35.66 | $65.67 | 184.2 |
| Second | 200 | 205.33 | 137.49 | 67.84 | 49.3 |
| Third | 300 | 312.00 | 243.10 | 68.90 | 28.3 |
| Fourth | 400 | 421.33 | 352.50 | 68.83 | 19.5 |
| Fifth | 500 | 533.33 | 467.41 | 65.92 | 14.1 |
| Sixth | 600 | 648.00 | 586.07 | 61.93 | 10.6 |
| Seventh | 700 | 765.33 | 710.11 | 55.22 | 7.8 |
| Eighth | 800 | 888.00 | 841.29 | 46.71 | 5.6 |
| Ninth | 900 | 1,016.00 | 984.75 | 31.25 | 3.2 |
| Tenth | 1,000 | 1,149.33 | 1,145.68 | 3.65 | .3 |

Page 119:

"The costs for the period (1927-1936) was 31.2 cents for each $1 paid to or preserved for certificate holders, * * *."

Page 184:

"Q. Of course, in any state, provisions like Blue Sky Acts would apply to corporations, no matter what their business, wouldn't they?

"A. That may be true, but I believe in the case of an investment company they usually exercise them more than they would over an ordinary business corporation.

Testimony of E. E. Crabb, Vice Pres., (Investor's Syndicate) before S. E. C., at public examination."

Page 193:

**Deposits by Investors Syndicate December 31, 1937**

| State | Amount of deposit* | Cash value of certificates outstanding |
|---|---|---|
| Alabama | $2,574,359.48 | $2,206,996.96 |
| California | 5,266,212.34 | 4,659,471.50 |
| Colorado | 25,066.47 | 1,699,142.45 |
| Connecticut | 3,655,947.62 | 3,043,956.81 |
| Florida | 147,068.86 | 1,042,579.06 |
| Georgia | 1,592,955.18 | 1,378,212.25 |
| Illinois | 1,175,394.19 | 1,355,142.83 |
| Iowa | 2,585,940.26 | 2,035,911.58 |
| Kansas | 4,649,612.98 | 4,373,613.31 |
| Louisiana | 551,234.44 | 463,249.06 |
| Maryland | 917,982.76 | 747,359.31 |
| Massachusetts | 2,965,302.19 | 2,635,390.83 |
| Minnesota | 125,260.27 | 7,856,240.32 |
| Missouri | 2,990,627.94 | 2,595,458.01 |
| Nebraska | 119,220.17 | 162,844.19 |
| Nevada | 25,107.02 | 102,108.36 |
| New Jersey | 30,079.76 | 1,469,928.48 |
| New York | 4,357,675.58 | 4,039,017.08 |
| North Carolina | 1,660,281.26 | 1,427,228.51 |
| North Dakota | 1,785,129.00 | 1,579,933.90 |
| Ohio | 100,265.87 | 206,489.28 |
| Oregon | 691,454.96 | 581,782.38 |
| Pennsylvania | 100,265.87 | 1,918,522.08 |
| South Dakota | 2,089,240.97 | 1,766,230.48 |
| Tennessee | 2,743,769.41 | 2,484,382.19 |
| Texas | 1,227,868.70 | 2,053,735.56 |
| Utah | 1,296,022.42 | 1,097,808.80 |
| Virginia | 100,363.28 | 1,717,084.50 |
| Washington | 983,690.57 | 865,738.88 |
| West Virginia | 1,674,893.48 | 1,480,497.15 |
| Wyoming | 60,755.07 | 258,030.42 |
| TOTAL | $48,269,048.37 | $59,291,086.52 |

*Securities at book values.

BREAKDOWN OF TABLE C; STATEMENT SHOWING LOCATION OF CONTRACT HOLDERS AND ASSETS GEOGRAPHICALLY AND IN PERCENTAGES

## DEPOSITORY STATES

### States Which Apparently Cannot and Probably Will Not Have Claim Against West Virginia Deposit

| | 1(a) | 2(b) | 3(c) | 4(b) | 5(d) | 6(b) | 7(e) |
|---|---|---|---|---|---|---|---|
| Iowa | 54 | | 34,478 27 | | 45,082 50 | | 130 |
| Wisconsin | 6,595 | | 2,342,978 73 | | 2,619,399 07 | | 111 |
| Missouri | 1,722 | | 786,988 86 | | 861,100 62 | | 109 |
| Alabama | 81 | | 31,346 71 | | 32,555 16 | | 103 |
| Delaware | 582 | | 290,175 36 | | 293,790 63 | | 101 |
| Tennessee | 567 | | 200,504 97 | | 196,574 38 | | 98 |
| Maryland | 1,152 | | 492,552 24 | | 470,806 25 | | 95 |
| Kentucky | 328 | | 92,690 42 | | 86,712 50 | | 93 |
| Illinois | 8,051 | | 4,225,790 75 | | 3,759,844 00 | | 89 |
| TOTAL 9 States | 19,132 | 38 3% | 8,497,506 31 | 36 2% | 8,365,915 11 | 41 7% | |

### States With Probable Claim Over Against West Virginia Deposit

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| Kansas | 254 | | 108,784 89 | | 83,337 50 | | 76 |
| Indiana | 846 | | 386,173 45 | | 162,863 44 | | 42 |
| Ohio | 6,059 | | 2,360,418 70 | | 509,573 44 | | 21 |
| Virginia | 1,406 | | 557,809 19 | | 27,703 13 | | 5 |
| Pennsylvania | 8,794 | | 4,668,582 25 | | 232,591 57 | | 5 |
| Total 5 States | 17,359 | 34 4% | 8,081,768 48 | 34 4% | 1,016,069 08 | 5 1% | |

(a) No. of contracts having reserve value or monthly payments being paid currently on 4/4/41.
(b) Percentage of total.
(c) Net cash liability April 10, 1941.
(d) Securities deposited market value June 6, 1941.
(e) Percentage of market value to cash liability.

# NON-DEPOSITORY STATES

## States With Less Than 100 Contracts

| | 1(a) | 2(b) | 3(c) | 4(b) |
|---|---|---|---|---|
| Arizona | 24 | | 10,191 82 | |
| Arkansas | 16 | | 8,221 58 | |
| Colorado | 25 | | 17,909 03 | |
| Idaho | 2 | | 1,263 00 | |
| Maine | 6 | | 2,484 50 | |
| Massachusetts | 98 | | 80,590 64 | |
| Mississippi | 21 | | 8,335 24 | |
| Montana | 4 | | 5,111 50 | |
| Nebraska | 24 | | 7,661 27 | |
| Nevada | 1 | | 312 50 | |
| New Hampshire | 9 | | 9,151 84 | |
| New Mexico | 11 | | 9,371 06 | |
| North Dakota | 9 | | 36,487 35 | |
| Oklahoma | 97 | | 105,815 64 | |
| Oregon | 8 | | 4,137 24 | |
| Rhode Island | 10 | | 6,647 71 | |
| South Dakota | 11 | | 6,785 12 | |
| Texas | 89 | | 37,529 08 | |
| Utah | 3 | | 1,944 00 | |
| Vermont | 6 | | 3,564 50 | |
| Washington | 41 | | 34,650 60 | |
| Wyoming | 6 | | 5,679 79 | |
| Total 22 States | 521 | 1% | 404,145 01 | 1 7% |

## States With Between 100 and 500 Contracts

| | | | | |
|---|---|---|---|---|
| California | 228 | | 169,577 35 | |
| Connecticut | 175 | | 116,276 09 | |
| Florida | 119 | | 97,946 02 | |
| Foreign Countries | 107 | | 72,811 33 | |
| Georgia | 254 | | 159,164 28 | |
| Louisiana | 301 | | 40,941 77 | |
| Minnesota | 284 | | 176,837 14 | |
| North Carolina | 117 | | 80,592 13 | |
| South Carolina | 256 | | 41,130 62 | |
| Total 9 States | 1,841 | 3 6% | 955,276 73 | 4 1% |

## States With Over 500 Contracts

| | | | | |
|---|---|---|---|---|
| District of Columbia | 1,658 | | 952,502 25 | |
| Michigan | 3,158 | | 1,447,607 32 | |
| New Jersey | 526 | | 285,356 15 | |
| New York | 1,019 | | 669,824 67 | |
| Total 4 States | 6,401 | 12 9% | 3,355,290 39 | 14 3% |
| Total 35 States | 8,763 | 17.5% | 4,714,712 13 | 20 1% |

FILE COPY

In the

# Supreme Court of the United States

October Term, 1942.

No. 319.

FIDELITY ASSURANCE ASSOCIATION AND CENTRAL TRUST COMPANY,

*Petitioners.*

*vs.*

EDGAR B. SIMS, AUDITOR OF THE STATE OF WEST VIRGINIA, ETC., ET AL.

*Respondents.*

## REPLY BRIEF ON BEHALF OF L. H. BROOKS, TRUSTEE, FREDERIC LEAKE AND A. L. GOLDBERG, JR., TRUSTEE, AND DEWEY S. GODFREY, RECEIVER FOR FIDELITY ASSURANCE ASSOCIATION, IN THE STATE OF MISSOURI.

ROY H. BEELER,
*Attorney-General,*
*State of Tennessee.*
NAT TIPTON,
*Assistant Attorney-General,*
*State of Tennessee.*
*Of Counsel for Tennessee Respondents.*

WELDON B. WHITE,
FYKE FARMER,
*Counsel for L. H. Brooks, Trustee, Frederic Leake and A. L. Goldberg, Jr., Trustee.*
RUDOLPH K. SCHURR,
*Counsel for Dewey S. Godfrey, Receiver in the State of Missouri.*

BAIRD-WARD—NASHVILLE

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## FOREWORD.

"We think it is our duty to review the situation realistically, and when this is done, there appears to be no reasonable hope of the reorganization of the business as a going concern, but only the *immediate** need of a liquidation of the company's assets for the benefit of the contract holders."

Opinion of Court of Appeals, Tr., p. 259.

"It is true that the broad picture developed by the testimony at the hearing does not present a very favorable view with respect to the rehabilitation and continued operation of the Debtor as a face-amount certificate company."

Opinion of District Judge, Tr. pp. 194-195.

*All italics herein are ours unless otherwise noted.

In the

# Supreme Court of the United States

October Term, 1942.

No. 319.

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*Petitioners,*

*vs.*

EDGAR B. SIMS, AUDITOR OF THE STATE OF WEST VIRGINIA, ETC., ET AL.

*Respondents.*

## REPLY BRIEF ON BEHALF OF L. H. BROOKS, TRUSTEE, FREDERIC LEAKE AND A. L. GOLDBERG, JR., TRUSTEE, AND DEWEY S. GODFREY, RECEIVER FOR FIDELITY ASSURANCE ASSOCIATION, IN THE STATE OF MISSOURI.

### STATEMENT AS TO THE ISSUES—GOOD FAITH.

Other respondents will discuss the question of whether or not Fidelity Assurance Association was such a corporation as could file a petition in bankruptcy. This brief will be confined to the question of good faith, and chiefly to that

phase pertaining to whether or not there is a reasonable likelihood of a plan of reorganization being effected.

The issues as regards this aspect of the case, no longer admit of any canon. They have gone on a rampage and are like the surging floodwaters that have broken out of the banks of the river channel. They are like Mistress Quickly of whom Falstaff said "A man knows not where to have her."

The Debtor's petition filed June 6, 1941, (Tr., p. 4) indicated a purpose of effecting reorganization through a modification of the rights of all contract holders in the security of the deposits with the Treasurer of the State of West Virginia and the officials and departments of other States, "so that the earnings received on securities and assets owned by Debtor will be sufficient in amount to meet the requirements under its outstanding contracts." (Tr. p. 7-8)

Debtor's pleading pitches its case for reorganization on this single issue.

This issue has either been overlooked or forgotten by counsel presently in the case. The case in this Court is made to rest upon the possibilities of *liquidation*. If the pleadings in the Chapter X proceedings on the issue of good faith serve the same purpose of pleadings in the ordinary equity case, in the case at bar there is ample cause to question whether the case put forward in the adversary briefs is not subject to the usual rules as to variance.

We regard the findings of the Circuit Court of Appeals and the District Court as being concurrent on the point of whether or not the Company can be reorganized to carry on

business. The brief of Securities & Exchange Commission indicates that it has the same view.

Petitioners and Securities & Exchange Commission know that the crucial question in this lawsuit is whether or not there is a reasonable likelihood of effecting a reorganization of Fidelity that will be *fair, equitable* and *feasible*. If they thought that Fidelity could be reorganized, they ought to have been able to say so in plain and direct language.

Nevertheless, we search their brief in vain for a single clear statement that *they* envisage the kind of reorganization which men ordinarily think of when they speak of reorganizing a corporation. When they come to this point, they skip over it with the agility of an expert skater jumping over a row of barrels and instantaneously commence talking about "other methods of disposition of the assets which will satisfy the requirements of Section 146 (3), such as "the creation of a new corporation or other *device to liquidate assets*." (Brief of Securities & Exchange Commission, p. 19)

It is true that the debtor and its Trustee in their brief refer to the opinion of several of the witnesses that Fidelity could be reorganized and add that there was much atmosphere or "color" about this proceeding substantiating these opinions. We submit that their opinions are entitled to be given very little weight. None of them are supported by any basis of fact from which such conclusion might legitimately be drawn. All of them had had some connection with the Company before the filing of the petition for reorganization, which made them interested (though not in each case pecuniarily) in saving Fidelity from dissolution.

It is a human disposition to postpone the admission of the inevitableness of failure and defeat as long as possible. A case in point is the profession of the leaders of France of a belief that some miracle would save her in the Spring of 1940, when the outside world knew that she was doomed.

The opinions of these witnesses that Fidelity could be reorganized were little more than the expression of hopes born of despair. The letter of John Marshall, dated June 17, 1941, to the publisher of the Wheeling *Intelligencer* (Original Tr. pp. 163-169) attests this fact. This is why the Court of Appeals said that the situation must be viewed realistically.

The Debtor and the Trustee make numerous suggestions—none of which they are ready to pin their faith on—and claim that they are "something" more than "remote possibilities." (Petitioner's Brief, p. 48) They completely fail, however, to conform any of these "suggestions" to the realities with which they must deal.

## THE STATE DEPOSITS—THE CRUX OF THE LAWSUIT.

The confusion that is so manifest in the thinking of petitioners and Securities & Exchange Commission is attributable to one thing—their refusal to reorganize the fixed and vested rights of contract holders in the deposits in West Virginia and the fourteen other states. Perhaps we should say that they refuse to *admit* that these fixed and vested rights exist. We are bound to credit them with *perceiving* these rights.

True it is, that insolvency alone will not bar reorganization. But insolvency coupled with the utter absence of any

likelihood of achieving solvency does bar reorganization. That is the case here.

The Circuit Court of Appeals summarized the situation by setting out in its opinion the following table and stating:

| State | Deposit by States as of June 6, 1941 Market Value | Liability by States as of April 10, 1941 Net Cash |
|---|---|---|
| Alabama | $ 32,555.16 | $ 31,346.71 |
| Delaware | 293,790.63 | 290,175.36 |
| Illinois | 3,759,894.00 | 4,225,790.75 |
| Indiana | 162,863.44 | 386,173.45 |
| Iowa | 45,082.50 | 34,478.27 |
| Kansas | 83,337.50 | 108,784.89 |
| Kentucky | 86,712.50 | 92,690.42 |
| Maryland | 470,806.25 | 492,552.24 |
| Missouri | 861,100.62 | 786,988.86 |
| Ohio | 509,573.44 | 2,360,418.70 |
| Pennsylvania | 232,591.57 | 4,668,582.25 |
| Tennessee | 196,574.38 | 200,504.97 |
| Virginia | 27,703.13 | 557,809.19 |
| West Virginia | 10,674,696.08 | 6,896,393.88* |
| Wisconsin | 2,619,399.07 | 2,342,978.73 |
| | $20,056,680.27 | $23,475,668.67 |

In addition, the Fidelity had undeposited securities of the market value of $556,467.51 on June 6, 1941, and approximately $500,000 in cash."

(Tr., p. 242)

*Of the liabilities shown opposite West Virginia $2,181,681.75 represent claims of West Virginia contract holders, and the balance of $4,714,712.13 the claims of contract holders in the States having no deposits.

The Federal Government has filed a preferred claim for income and excess profit taxes for the taxable years 1935, 1936, 1937, 1938 and ten months of 1939, amounting to nearly $300,000.00. (Tr., pp. 1220-1223) It is plainly to be seen that the nondeposited securities and assets would be practically consumed in paying taxes, expenses of administration, fees, etc.

Manifestly, no sort of a plan of reorganization could be effected which does not deal with the deposited securities. Debtor's petition presupposes some kind of omnipotence in the Federal Court capable of effecting a recapture of these deposits for use in supplying the deficiency of more than two and a half million dollars between the assets and liabilities of the company so that it can continue in business. In other words, it necessarily contemplates the carving of working capital out of the assets held in trust for contract holders.

There could be no sort of reorganization that does not eliminate the deficiency between assets and liabilities. If the company is to continue in business as a face-amount certificate company, as an insurance company, or as any other kind of company, it would have to be launched in a condition of solvency. The only other alternative, it occurs to us, would be the sale or transfer of a part of the Debtor's business to some other company that is already functioning; and again insolvency is a barrier to such a plan. No business man would take over assets with liabilities in excess of what he is getting.

Now when a business is insolvent—that is, when its liabilities are in excess of its asset—solvency can be attained in one of two ways only. Either the assets must be increased or the liabilities must be decreased. The assets of this com-

pany can be brought up to equal its liabilities only by new money being put in from the outside. All will agree that this is out of the question. The efforts of the company's directors and officers extending over a period of several years prior to the filing of the petition to bring in new capital demonstrate that this possibility has already been exhausted.

This leaves the possibility of scaling down the liabilities. It would not be enough to make them merely equal the assets. The liabilities would have to be brought way below the assets so as to free money from the trusts in which the securities are held to make capital and for use in paying operating expenses.

It is our belief that nothing like this has ever been attempted in the annals of corporate reorganizations. The crucial question in the case, therefore, is: How can the Bankruptcy Court use the State deposits as a basis for reorganization?

At the commencement of this proceeding it was reorganization through *modification* of the contract holders rights in the State deposits which was sought. Now, petitioners and Securities & Exchange Commission's plea is for reorganization through *exploration*, as to these contract holders rights. It has simmered down to this! *Does the good-faith requirement of Chapter X mean nothing more than that a Bankruptcy Court will have jurisdiction of a reorganization petition to enable Securities & Exchange Commission to investigate and explore in order to see if it cannot devise some method of disposition of the bankrupt's assets "as slowly as necessary and as expeditiously as possible under the circumstances?"*

But whether the proponents of reorganization are thinking of reorganization in the usual sense or an exploration with a view to the creation of a new corporation or some other device for liquidation, they must face—as so far they will not—the dominant fact in this lawsuit: That there is nothing to work with except the $10,000,000 of securities held in the West Virginia deposit and a like amount held in the deposits in the fourteen other States and *that these deposits they cannot touch.* Another proposition is equally true: That they cannot torture Chapter X of the Bankruptcy Act so as to make it serve this end.

## THERE ARE NO PROBLEMS OF "MARSHALING" ASSETS.

There need not be, in the case of Fidelity, any complex and difficult problems of creditors' rights involving the marshalling of assets. The distribution of Fidelity's deposits can be simple and easy. When the case is seen in its true light, there are no perplexing legal problems.

In the first place there is no conflict between contract holders in the States which have deposits and contract holders in the States which do not have their own deposits. The simple fact is that fourteen States outside of West Virginia required Fidelity to make deposits of assets to secure liabilities in those States. About the same number of other States did not have such requirements in their laws. They were content to rely upon the protection afforded by the laws of the State of West Virginia which required a deposit in that State to cover all outstanding liabilities that were not elsewhere secured.

Securities & Exchange Commission, instead of speaking of "unsolved" problems of "interfund accountings and marshalling of assets by series" which does create confusion, should have stated its proposition in plainer terms. "Marshalling" in the sense in which they have employed it means nothing more nor less than the annihilation of the State deposits. It is but a recurrent phase of the old attempt to lay hold upon the State deposits. Instead of *modifying* the contract holders rights in the State deposit, they are now talking about *marshalling* the assets.

That Fidelity sold more than one series of contracts, that it failed to segregate the moneys which it received according to the contract series, and that its books show some interfund "loans" or other transfers, do not alter the fact that contract holders have vested rights in the securities deposited in the several State deposits at the time of the filing of the petition. These rights cannot be modified against the contract holders' consent. They cannot be abrogated indirectly by some kind of "marshalling" of the securities as between the several deposits.

It will clarify the confusion—arising not so much from the actual situation as from the way it has been presented in the adversary briefs—for us to look to the condition under which the State deposits were created. The difficulties which obsess Securities & Exchange Commission vanish as soon as we stop pondering "the complex task of disentangling the assets" and examine the facts.

## STATE DEPOSITS CONSTITUTE TRUST FUNDS FOR CONTRACT HOLDERS.

The statutes of the State of Tennessee require investment companies, such as the Debtor, as a condition to the right to engage in business in that State, to deposit and maintain securities at no time less than 100 per cent of the issuing company's cash or current contract liability on all outstanding investment contracts sold in the State of Tennessee. By Chapter 209 of the Public Acts of 1939, it was provided that the Commissioner of Insurance and Banking of the State of Tennessee should hold as Custodian the securities deposited for the benefit of the holders of the investment contracts coming within the provisions of said Act. By Chapter No. 157 of the Public Acts of 1941, the State Treasurer of Tennessee was made the Custodian of all securities deposited with the State or any Department thereof. The laws of Tennessee further provide that only upon discharge in full of all liabilities on all investment contracts sold in the State of Tennessee, and for which trust deposit is maintained, shall the issuing company be entitled to a release and return of the securities so deposited.

In compliance with the laws of the State of Tennessee, and in order to obtain a permit to do business and issue its investment contracts in the State of Tennessee, the Debtor company made a deposit of securities with the Commissioner of Insurance and Banking of the State of Tennessee. Citizens of the State of Tennessee, in reliance upon the protection afforded by the laws of that State, purchased the investment contracts issued by Debtor.

The evidence adduced on the hearing discloses that the company, in the latter years of its existence, was able to

keep its head above water by issuing certificates with some variation in name and terms or features.* The implications in the brief of Securities & Exchange Commission that it was only in the later series of contracts that Fidelity agreed to segregate reserve funds are not correct.

The different contracts themselves when analyzed furnish conclusive evidence that no trust could come into existence until securities were deposited with State officials. In the first place, the contract holder was to make his payments *to the Company*. Undoubtedly when these payments were received by the Company a *debtor-creditor* relationship and not a *trust* arose. The Company agreed unconditionally (so far as reserve funds were concerned) to make the payments to the contract holder when due according to the terms of the contract. The point is that the Company did not agree to pay merely *out* of the separate reserve fund. The contract holder's right to receive the payments from the Company was not limited to any special or segregated fund.

In the Series B contract which was issued from 1934 on, the heading read:

**"PROVISIONS.**

**This contract is issued upon the agreement of the association to maintain the required reserve fund, to distribute the apportioned surplus thereof to registered holders of matured income reserve contracts series B, *to deposit approved securities in trust as required by the laws of the State of West Virginia* and to pay and retire contracts in accordance with their provisions."**

*For the different types of contracts or certificates and the varying terms and provisions thereof, see pages 79-80 and 164 of the Report of the Securities & Exchange Commission on *Companies Issuing Face-Amount Installment Certificates*.

While there is some slight difference between the wording of the section relating to the reserve fund contained in the different contracts, in substance the provision is the same. By this section (Section 1, Reserve Fund), the Company agreed to *create* and maintain a reserve fund. It was to be a special fund for the discharge of its liability under the different Series contracts. The reserve fund was to be set aside from payments received under the different Series contracts. This reserve fund was to be invested in approved securities *and deposited in trust, as required by the laws of the State of West Virginia.*

It is of special significance that the amount set aside for the reserve fund was to be the *total* amount of all payments, less administrative and agency charges, withdrawals and taxes. This, we believe, is a fair statement of the provisions of the Series B contracts. For the Special Annuity contracts, the amount set aside was to be the amount of all payments, less fixed administrative charges and necessary agency expenses. The Special Annuity contracts did not provide for the deduction of withdrawals and taxes.

Therefore, the entire amount paid in, less running expenses, was to constitute the reserve fund. This fund was to be created when it was invested in approved securities. So long as they were held by the Company, they were still general or unpledged assets. Only when the securities were *deposited in trust*, as required by the laws of the State of West Virginia, did a trust come into existence.

The laws of the State of West Virginia required a deposit *in trust* of bonds and securities approved by the Insurance Commissioner "to an amount equal to the total amount which such person, association or corporation may be liable

to pay in cash to the holders of contracts under the terms thereof at the time of the deposit." As stated by the Court of Appeals in its opinion, it was further provided by the West Virginia laws that wherever other States required the corporation to make deposits to secure contract holders, the amount of the deposits in such other States might be deducted from the total amount required to be deposited with the Treasurer of the State of West Virginia.

These provisions, which were a part of the West Virginia laws, were, of course, by the provisions of the contract incorporated as a part of the contractual obligations of the Investment Company. Thus, when the Company deposited securities in Tennessee in accordance with the laws of the State of West Virginia, credit therefor was given against the West Virginia deposit. This was in compliance with the provisions of the contract that a reserve fund would be invested in approved securities and *deposited in trust*. The Tennessee statutes in this regard are unambiguous. The amount of the deposit was to be not less than one hundred per cent of the cash or current contract liability on all outstanding investment contracts sold in the State of Tennessee.

Clearly no valid trust came into existence at any time until the securities were deposited by the company with the State depositaries. This means, of course, change of possession, actual or constructive. Such book entries as the Company made for the purpose of segregating reserve funds by series contracts plainly did not amount to the creation of a separate trust for the contract holders of the different series. In the first place, there was no agreement that the Company itself would be a trustee. The contract did not contemplate

that there would be a trust fund or *res* until the reserve fund was deposited *in trust* as required by the States laws.*

The applicability of a principle which makes a trust *res* necessary for the creation of a trust is emphasized by the facts, so well illustrated in this record that, until the Company transferred securities to the State depositaries, they were still (notwithstanding bookkeeping entries) under the unrestricted dominion and control of the Company. They should be "switched" about from one ledger account to another. They could be "loaned," or "advanced." The record shows many such transactions in very large sums. There was no attempt even to make separate bookkeeping entries until the latter years of the Company's existence. (See complaint filed by S. E. C. and supporting affidavits in Report on Companies Issuing Face-Amount Installment Certificates, pp. 196, *et seq.*)

The evidence shows that with comparatively few exceptions (which are trivial and must be disregarded in the approach to the primary and basic question of the rights of contract holders in the State deposits generally) the Company in sending deposits to the State depositaries, did not specify the particular series fund from which the securities came. (Tr., pp. 754-756, 768, 769) The types of reports which were sent out are shown by Exhibits 72, 73, 74, 75, 76, 77 and 78.

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* *McKey* v. *Paradise*, 299 U. S., 119, 57 S. Ct., 124 81 L. Ed., 75; *Blakey* v. *Branson*, 286 U. S., 254, 52 S. Ct., 516, 76 L. Ed., 1089; *National City Bank* v. *Hotchkiss*, 231 U. S., 50, 34 S Ct., Rep., 20, 58 L. Ed., 115;

Restatement Law of Trusts, Sec. 87.

The law in West Virginia was settled by its Supreme Court of Appeals in the recent case of *Inter-Ocean Casualty Company* v. *Leccony Smokeless Fuel Company, et al*—W. Va.—17 S.E. (2d) 51, 137 A.L.R., 488, in accordance with the rule of *McKey* v. *Paradise*, 299 U. S., 119, 57 S. Ct., 124, 81 L. Ed., 75.

The Securities & Exchange Commission fails to cite the record in support of its statement that the States accepted securities in disregard of knowledge or notice that the assets deposited belonged to particular series funds and were deposited to secure liabilities of other series. (Brief, pp. 36-37) There is no evidence that this happened. To make it perfectly clear, we are printing in the Appendix to our brief copies of the reports sent to Tennessee which were filed as Exhibit 77. (Tr., p. 756)

It has not been suggested that the rights of contract holders in the State deposits may be so far ignored as to bring all the deposited securities into one general pot with the general assets of Debtor so as to make all contract holders mere general creditors. All that is proposed is some "disentangling" of the assets by series funds. It would seem that nothing short of some superior rights of contract holder springing from a trust relationship by series funds would warrant such an invasion of the State deposits.

It will tend to clarify all the other points in the case, if we consider two fundamental legal propositions as established:

(a) No trust relationship between Fidelity and any series of contract holders ever arose or now exists or may hereafter be created by reason of the agreement of Fidelity expressed in the contracts to create and maintain separate reserve funds for each series contract; and

(b) Valid trusts or pledges of collateral security creating vested rights in favor of the contract holders entitled to benefit therefrom did come into existence when securities were deposited by the Company with State depositaries.

The relationship between Fidelity and the contract holders is that of debtor and creditor, pure and simple. The State deposit laws, and not the contracts, give rise to the trust relationship. By virtue of the statutes requiring the deposits, the contract holders entitled to the benefits therefrom as a matter of State policy acquired protective lien or trust rights in the deposited securities superior to those of the company or its other creditors in such assets. *American United Life Insurance Company* v. *Fischer* (C.C.A. 8th) 130 F. (2d) 643, 646.

When the brief of Securities & Exchange Commission is carefully read, it will be seen that the Commission avoids expressing any view of its own contrary to these propositions. To our minds, it is clear that the Commission does not have the conviction that an attempt by contract holders to set up trust funds according to the several series of contracts in derogation of State deposit laws will be successful. Disappointed contract holders may have claims against the company for breach of the agreement to create and maintain separate reserve funds by each series contract, but the attempt to enforce such claims will avail them nothing, because they can point to no trust *res* which they are entitled to trace. Those contract holders who are entitled to the benefit of the State deposits stand as *bona fide* purchasers having vested lien or trust rights in the disputed securities. *American United Life Insurance Company* v. *Fischer*, *Supra*.

This view is confirmed by the statement on Page 1 of the Report of Securities & Exchange Commission on Companies Issuing Face-Amount Installment Certificates that, irrespective of their designation, these face-amount installment certificates are in essence simply unsecured obligations of

the companies which issue them to pay a specified sum to the holder at a specified future date. The footnote mentions the trusts by reason of the State deposit laws.

The authors of the brief on behalf of Debtor and the Trustee are almost as circumspect as the Commission. Although they say it is a "real question" whether any or all of the several series of contracts have resulted in the creation of trusts in particular assets for the benefit of creditors (p. 57), they are extremely careful to avoid vouching such a theory. Not one of our adversaries has the rashness to assert that any of the several series of contracts resulted in the creation of trusts in particular assets, except insofar as trusts came into being by reason of the State laws.

From whence then arise any rights or equities in favor of any contract holders which are superior to the vested rights of contract holders in the States having the deposits? *Securities & Exchange Commission ought to be willing to answer this question or cease all talk about marshalling the several State deposits.*

All contract holders in this case are secured creditors, for all are entitled to the benefit of the security of the West Virginia deposit. But contract holders claiming their security, not by virtue of any State deposit, and instead claiming securities held in State deposits on the theory of a trust relationship resulting from a contractual obligation of Fidelity, will find themselves in the position of common or unsecured creditors. At least they will be insofar as they may seek to recover securities from the States having the deposits. The mere equities which they assert will be subordinate to the substantive rights in the deposited securities which had previously vested under the State laws and which by virtue of the insolvency and receivership proceedings

had acquired an exclusively local situs. *American United Life Insurance Company* v. *Fischer, Supra.*

Any plan which compels secured creditors to surrender without adequate consideration to the benefit of other creditors, whether secured or unsecured, the superior rights which they have acquired is inequitable and unfair. *Consolidated Rock Products Company* v. *Du Bois*, 312 U. S., 510, 61 S. Ct., 675, 85 L. Ed., 982.

Surely there can be no gainsaying the following statement by the Court of Appeals:

> "*. . . certainly the possibility that thousands of contract holders could be persuaded to modify their contracts and scale down their claims to enable the company to go on is so remote as to exist only in the imagination. . . No proposal for the investment of new capital has been forthcoming.*" The facts underlying the whole situation are so clear that even the parties in this case who insist upon reorganization under the Bankruptcy Act hold out little hope of a resumption of the business as a going concern, and content themselves for the most part with the argument that reorganization in the statutory sense includes 'a slow and orderly liquidation.'" (Tr., p. 260)

A Bankruptcy Court is a Court of equity, but it cannot disregard or impair liens created by State laws. This is prohibited by Section 67 (b) of the Bankruptcy Act, which, by virtue of Section 102, is applicable to proceedings under Chapter X. If the Bankruptcy Court has no power to destroy, abridge or adjust a State deposit, may it hold that the petition to reorganize is filed in good faith merely in order to afford opportunity to the Trustee to try to discover ways of doing that?

## CONGRESS HAS CONFERRED NO POWER IN BANKRUPTCY COURT OVER FIDELITY'S DEPOSITS.

Fidelity never came under any Federal regulation. During its entire existence it was regulated by the State authorities. All of the deposits which were made were in pursuance to State laws. No reason whatsoever is shown why the Federal Court should have any jurisdiction to nullify the rights which have been thus created.

The Securities & Exchange Commission had been studying investment trusts and investment companies for four years before the Investment Company Act undertaking to regulate face-amount certificate companies was recommended to Congress for enactment. The study was commenced in pursuance to the mandate contained in Section 30 of the Public Utility Holding Company Act of 1935.

The Investment Company Act of 1940 (Title 15 U.S.C.A., Sec. 80a) expressly recites that it was upon the basis of facts disclosed by the record and reports of Securities & Exchange Commission and facts otherwise disclosed and ascertained, that it was found that investment companies were affected with a national public interest. The special report on *Companies Issuing Face-amount Installment Certificates* was a part of its over-all report on its study of investment trusts and investment companies. Chapter V of this Special Report deals with the subject of Governmental Regulation of face-amount certificate companies.* These deposits with State officials of cash and securities are referred

*It is significant that it was reported that these companies "are essentially moneyed corporations, the regulation of which would seem to present problems in many respects comparable to the regulation of other types of moneyed corporations *such as insurance companies and banks.*" (p. 125)

to as "collateral security for the performance of the Company's obligations." (Page 128) On the same page is set out a summary of the deposit requirements of the various State statutes. Table 34 on Page 130 sets out the amount of deposits and cash surrender liability of certificates outstanding of Fidelity Investment Association by States as of December 31, 1937.

In 1938, the Securities & Exchange Commission had obtained an injunction in the United States District Court for the Eastern District of Michigan against Fidelity Investment Association, enjoining it, among other things, from: "A. 1. Purchasing and depositing with West Virginia, or any other State, insufficient securities or securities which do not meet deposit requirements." (Special Report, p. 257).

The variation in State deposit laws was made the subject of a special study by the Senate and House Committees, to which the Investment Company Act was referred. Commissioner Healy was the first to point it out. (See hearings before Sub-Committee of the Committee on Interstate and Foreign Commerce on H.R. 10065. Page 62.)

Mr. Schenker, counsel for the Securities & Exchange Commission made the following statement:

"... this bill in no way, Senator Herring, touches deposits that have been made to secure certificates issued up to the time of the passage of this bill." (Original printed transcript, p. 234)

The report of Senator Wagner, Chairman of the Committee on Banking and Currency, accompanying the bill, states:

"*The bill preserves the rights of residents in those States which require specific deposits with their State officials but makes provision for equalization of treatment of all certificate holders*, by providing that residents of other States must receive an amount equal to that received by the residents of States with deposits, before the latter can share in the general assets of the bankrupt company. (Sec. 29.)". (Italics ours)

We ask the Court to give special attention to the memorandum as to the hearings preceding the enactment of the Bill set out in the original printed transcript at pages 226 to 237.

It is highly significant that the Securities & Exchange Commission in its report to Congress stated that neither of the two major companies (Fidelity Investment Association and Investors Syndicate) had registered their certificates under the Securities Act of 1933 "presumably by reason of the exemption in Section 3 (a) (8) of that Act." The footnote to said sentence points out that:

"Sec. 3 (a) (8) of the Securities Act of 1933 includes among the securities exempted from the registration and prospectus requirement of the Act, 'any insurance or endowment policy or annuity contract or optional annuity contract, issued by a corporation subject to the supervision of the insurance commissioner, bank commissioner, or any agency or officer performing like functions, of any State or Territory of the United States or the District of Columbia.'"

Part Two, Statistical Survey of Investment Trusts and Investment Companies, p. 228;

See also p. 132, Report on *Companies Issuing Face-Amount Installment Certificates*.

Commissioner Healy, in his statement before the Sub-Committee of the Committee on Banking and Currency of the United States Senate, preceding the passage of the bill, compared these companies to savings banks (Part One hearings on S. 3580, pp. 33, 38).

Thus, until the enactment of the Investment Company Act of 1940, the Securities & Exchange Commission evidently held the view that investment companies selling face-amount certificates were exempted from the registration of their certificates under the Securities Act of 1933.*

It is as plain as the noon-day that so far as Fidelity is concerned, no greater power over State deposits exists in the Bankruptcy Court since the enactment of the Investment Company Act, than there was before. We have seen that it was not the intention of Congress to disturb the State deposits as they existed on the effective date of the Act, which was January 1st, 1941. As Mr. Schenker stated to the Senate Sub-Committee on Banking and Currency, "meticulous care" was taken to see that those States wich had de-

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*By the same token, it would seem that a face-amount certificate company would not be the type of corporation that could file a petition in bankruptcy, because it possessed the essential characteristics of an insurance or banking corporation. (Sec. 4 (b) of the Bankruptcy Act.)

**It is worthy of note that neither prior to the enactment of the Investment Company Act nor as a result of the amendment to that Act was any *special* provision made for the *reorganization* of face-amount certificate companies. Whereas, the Bankruptcy Act contained separate chapters with carefully framed provisions concerning Agricultural Compositions and Extensions, Railroad Reorgnizations, Debt Readjustments by Municipalities and Taxing Districts, Corporate Reorganizations, Arrangements, Real Property Arrangements and Wage Earners Plan, this simple amendment designed to facilitate the *liquidation* of face-amount certificate companies and the distribution of the deposits made after January 1, 1941 was added by the Investment Company Act as an amendment to Section 67 of the Chapter relating to ordinary bankruptcy. It is in such striking contrast to the carefully detailed methods set up with respect to other types of corporations as to make it exceedingly doubtful whether in any event there would be jurisdiction in the Bankruptcy Court, to attempt to *rehabilitate*, a face-amount certificate company as a going concern. But this is not a determinative question.

posits could hold on to them. (Original printed Transcript, p. 229)

The Investment Company Act embodied a separate section headed "Bankruptcy of Face-Amount Certificate Companies." This Section 29 undertakes to amend Section 67 of the Bankruptcy Act so as to give the Bankruptcy Court summary jurisdiction over State deposits in proceedings for the *liquidation* of face-amount certificates companies.**

Section 29 expressly provides that it applies only to the deposit of securities made by a face-amount certificate company on or after January 1, 1941. Deposits made prior to that time may not be avoided by the Trustee, and the Bankruptcy Court is given no summary jurisdiction of any proceedings to hear and determine the rights of any parties with respect to such deposits. It is to be borne in mind that all of the deposits of Fidelity were made prior to January 1, 1941.

The Act contained an express reservation of the jurisdiction of State authorities. Section 50 provides as follows:

> ". . . nor shall anything in this title effect the jurisdiction of any other commission, board, agency, or officer of the United States or of any State or political subdivision of any State, over any person, *security*, or transaction, insofar as such jurisdiction does not conflict with any provision of this title or of any rule, regulation, or order hereunder."

The proof is irrefragable that Congress thoroughly considered the question of the application of the bankruptcy power to the then existing deposits and deliberately decided

to confer *no power* upon the Bankruptcy Court over deposits as they existed when the Act took effect.

Fidelity's deposits before the Investment Company Act was enacted were not subject to the summary power of a court of bankruptcy. They did not become subject to such summary jurisdiction after the Act took effect. Indeed, the failure of Congress to amend the reorganization sections of the Bankruptcy Act, when the Investment Company Act was passed is persuasive that it was not intended that those sections of the Bankruptcy Act, so ill-adapted to the processes of reorganizing a face-amount certificate company, would be resorted to as the basis for such summary jurisdiction.

When consideration is given to the clear intent of Congress to leave the existing deposits undisturbed, it would not be consonant with justice to arrive at the result aimed at by the petitioners by resort to any forced or strained construction of the provisions of Chapter X of the Bankruptcy Act.

The reason that we insist that the question of the rights of contract holders in the State deposits is *crucial* is that the disposition of the question of the want of power in the Bankruptcy Court to avoid the State deposits will leave the Debtor with practically no property that can be made the basis of a reorganization. As soon as this question is determined—as it seems to us that it must be against any power in the Bankruptcy Court to abrogate or cut down the State deposits—the dismissal of the petition is required.

## PROCEEDINGS IN STATE COURT IN TENNESSEE.

The transcript of the proceedings in the Chancery Court of Davidson County, Tennessee, filed as an exhibit to the answer of the defendants to the Debtor's petition for reorganization shows that prior to the time the petition was filed, a suit was pending in the State Court to subject the deposit in Tennessee to the satisfaction of the claims of contract holders entitled to the benefit of deposit in that State. The deposited securities were then being held by the State Treasurer in pursuance to the statutes of that State, making him the Custodian of the deposit. By decree of the Chancery Court he had been enjoined from disposing of the deposit in any way except under orders of that Court. The time had been fixed for the filing of the claims of creditors and many claims had already been filed. Since that time many other claims have been filed. The time expired on November 1, 1941.

But for the injunction or stay in the order of August 9, 1941, the Tennessee State Court could have proceeded with the distribution of the deposit in Tennessee after November 1, 1941. *The Debtor has no equity in the Tennessee deposit.* (Original Transcript, p. 225)

By reason of these facts, the deposit in Tennessee cannot be affected in any way by any attempt to reorganize the Debtor except by delaying distribution. Even if there is an attempt to effect a plan of reorganization, any plan of reorganization must give the Tennessee contract holders the option of obtaining satisfaction of their entire claims out of the deposit in Tennessee. This deposit under the laws of the State cannot be withdrawn until the discharge in full of all claims of Tennessee contract holders. Since in Tennes-

see the Insurance Commissioner is prevented by statute from giving an investment company a license to do business unless it maintains a deposit of 100% of the amount of its cash liabilities to the holders of investment contracts sold in the State, there can be no scaling down *in invitum* of the claims of contract holders against the deposit so as to free any of the deposited securities for use in equalizing deficiencies in other States or to furnish working capital.

Respondents duly moved to vacate and set aside the stay order made by the District Court so as to permit the Chancery proceedings in the State Court to be prosecuted. Their motion was overruled by the District Judge. The Court of Appeals correctly envisaged the situation with respect to the State deposits generally, and concluded that it would be unjust and unreasonable to these contract holders to delay the satisfaction of their claims in order that illusory hopes of reorganization may be entertained.

## PROCEEDINGS IN STATE COURT IN MISSOURI.

It is to the Missouri deposit that the Missouri contract holders must look for payment. The Commissioner of Securities in Missouri required the Debtor corporation, as a condition to the right to do business in that State, to deposit in trust for the benefit of Missouri contract holders securities equal to the amount of outstanding liabilities in that State. Prior to the appointment of the State Court receivers and prior to the filing of the petition for reorganization, the Attorney-General for the State of Missouri, on the information of the Commissioner of Securities, instituted a proceeding in the Missouri State Court and obtained the appointment of a receiver.

When the Missouri contract holders purchased their contracts, they were led to believe (as shown by Exhibits 37, 38, 39, 40, 85, 86 and 87) that they need look no further than the Missouri deposit for their protection, in payment of their contracts. The question with them is, when are they going to get their money? None of them would have turned his money over to Fidelity if he had contemplated the slightest possibility of the deposit in his State becoming involved in protracted and expensive litigation in a Federal Court nearly one thousand miles distant.

The deposit in Missouri is not substantially in excess of its liabilities to residents of Missouri, if at all. The finding of the Circuit Court of Appeals that there was no substantial showing that surpluses existed in any State other than West Virginia (Tr., p. 261) is not challenged.

The Missouri contract holders are not concerned with the deposits in the State of Maryland or in Tennessee or in West Virginia, or in any other State which required deposits for the protection of contract holders in that State. They have no purpose to deprive any other State of any of the benefits of deposits made therein in accordance with applicable laws and regulations of the several Insurance and Securities Commissioners. The claim of the average contract holder is of a small amount. They can see nothing but injustice to the contract holders in any scheme or plan that has for its purpose the handling of all claims of all contract holders in the State of West Virginia, regardless of the State in which the contract holders reside.

## STATE DEPOSITS CONSTITUTE PROPERTY HELD ADVERSELY TO BANKRUPT ESTATE.

While there are no decisions in Tennessee on the legal rights of contract holders arising from the deposit of securities by investment companies in that State, there is a plain analogy to deposit of securities by insurance companies. In *Pennebaker* v. *Tomlinson* (Cooper's), 1 Tenn., Chy., 111, it was held that the Tennessee law requiring a deposit of bonds by an insurance company doing business in the State was equivalent to a statutory mortgage for the benefit of all citizens of the State having risks. *The Tennessee statute, in compliance with which Fidelity made the deposit, is so plain that it needs no construction.*

In *Davis* v. *Amra Grotto M. O. V. P. E. R., Inc., et al.*, 169 Tenn. 564, 89 S. W., (2d) 754, 106 A. L. R., 1506, petition to rehear denied 170 Tenn., 19, 91 S. W. (2d) 294, 106 A. L. R. 1506, in which funds belonging to an insolvent foreign insurance company, domesticated in Tennessee, were impounded by a general creditors bill in the State courts, the Supreme Court of Tennessee declared the public policy of the State of Tennessee as follows:

> "It has long been the public policy of this state, declared through the decisions of this court, to retain within the state all assets of foreign corporations found within the state, and upon the insolvency of such corporations, to treat these assets as a trust fund, and to distribute them ratably among creditors. This is a sovereign right possessed by the state, consistently exercised, and one which we will protect and enforce."

The above case does not involve a statutory deposit for the benefit of residents of the State of Tennessee. There

can be no question but that by virtue of the statute requiring the deposit of foreign investment companies, as a condition to doing business in the State of Tennessee, the deposit of securities rendered them subject to process within the State.*

Since the Trustee in Bankruptcy is not a purchaser for value, but stands in the shoes of the Debtor, it can assert no right having precedence over the lien which the Tennessee contract holders acquired.

This Court, on January 5, 1942 (which by a rare coincidence was the same day on which the District Judge rendered his opinion in the case at bar) denied *certiorari* in the case of In Re Mt. Forest Fur Farms of America, Inc., (6 C. C. A.), 122 F. (2d) 232, 314 U. S., 701, 62 S. Ct., 480, 86 L. Ed., 561. The Sixth Circuit Court of Appeals in its opinion said:

> "Neither exclusive jurisdiction of the debtor nor power to issue process outside the district confers upon the bankruptcy court the power, in a summary proceeding, to decide, without the consent of an adverse claimant, a controversy concerning property in his possession, unless his claim be merely colorable. Were it otherwise, every *bona fide* possessor of property held adversely to a bankrupt could be haled into a distant Federal Court to defend his right to the property when-

*In *E. & J. Northman, etc., v. Liverpool, London and Globe Insurance Company*, 1 Tenn. Chy., (Cooper's) 312, the Court said:

"But if it be conceded that the demand is purely legal, the fact that the insurance companies are non-residents, and that there is a *trust fund* in the hands of their co-defendant, the state comptroller, deposited by the companies for the express benefit of such claimants as the complainant alleges he is, is sufficient to give the court jurisdiction."

Cf. *United States v. Knott*, 298 U. S., 544, 56 S. Ct., 902, 80 L. Ed., 1321, 104 A. L. R., 741.

ever the trustee in a reorganization proceeding should choose to corral him summarily."

The authorities on the question convince us that the adverse claims to the various State deposits may not be disposed of summarily as the District Court undertook to do. A summary determination of these substantial claims arising under State laws, the validity of which is in no way questioned in this proceedings, seems to us to run squarely contrary to the principles announced by the Circuit Court of Appeals for the Fourth Circuit in *Warder* v. *Brady*, 115 F. (2d), 89.

This view also has the support of *Dannel* v. *Wilson-Weesner-Wilkinson Company*, 109 F. (2d), 364, another decision by the Circuit Court of Appeals for the Sixth Circuit. The question there was whether or not the retainage in the hands of the Commissioner of the Department of Highways of the State of Tennessee which was reserved by statute for the benefit of unsatisfied laborers and furnishers of materials on State highways, and which was in the custody of the State and was to remain until the debts of the contractor in the construction of highways were satisfied, constituted property of the bankrupt. There, as here, the right to administer the fund was in issue. There was no surplus belonging to the bankrupt. The Court said:

> "He retained the fund under authority of the statutes of Tennessee and the decree of the Chancery Court for such parties as would be found entitled to it, among which were parties claiming adversely to the trustee. We have held that where a fund is in the possession of a legal custodian for claimants who are asserting rights adverse to those of the trustee in bankruptcy, and they,

in accordance with law, invoke the aid of a proper State Court to perfect and enforce their lien, that they are adverse claimants. In re Farrell, 6 Cir., 201 F. 338; In re Rohrer, 6 Cir., 177 F. 381."

Neither the Investment Company Act nor any other Federal statute confers any power upon a Federal Court sitting in bankruptcy to avoid the deposits of the Debtor made in the various States because: (a) whereas the amendment to the Bankruptcy Act (Sec. 67 (f)) does confer power to require State deposits to be turned over to the trustee, this power is *limited* to deposits for the benefit of the holders of securities sold *on or after January 1, 1941*; and, (b) no power was conferred upon the Trustee to use the turned-over deposits for any purpose except *liquidation and distribution* of the net proceeds thereof to creditors entitled thereto under the provisions of the law or agreement providing for the deposit. (Sec. 67 (f) (3))

There has been no suggestion of any invalidity of any of the State statutes regulating the investment companies in pursuance to which the deposits with State officials were made. It is merely contended that all of these precautions which the States took for the protection of the investors in these companies against the day when there might be some failure on the part of the companies to meet their obligations, *now that that day has arrived, must be held for naught.*

Surely no court of equity would countenance for a minute such an attempt to undo the valid and salutary safeguards thrown up by the States to protect their citizens against the disaster which has come, except on grounds of a clear viola-

tion of some express prohibition in the Federal Constitution against State legislation of such character, Seven years have elapsed since Securities & Exchange Commission commenced its study of these companies, and no suggestion that the States did not have the power to require this protection for their citizens has yet been made, *by anyone*, so far as we know.

## INVALID STAY OF TENNESSEE PROCEEDINGS.

But for the injunction or stay in the order of August 9, 1941, the Tennessee State Court could have proceeded with distribution of the deposit in Tennessee after November 1, 1941, the time fixed for filing claims. These respondents, on September 15, 1941, filed in the District Court a motion to modify this order so as to permit the State Court to proceed with the distribution. (Tr., pp. 128-130) The District Judge reserved decision on this motion until his decision on the issues raised on the good faith hearing. His order sustaining jurisdiction overruled all the motions for dissolution of the injunction "freezing" the deposits in the hands of the State depositaries. (Tr., p. 202)

Respondents prayed a broad appeal and in their brief before the Circuit Court of Appeals assigned error on the action of the lower Court in overruling their motion for modification of the injunction. Inasmuch as the Circuit Court of Appeals held that jurisdiction in the lower Court was entirely lacking, there was no express ruling on this motion. The order of the Circuit Court of Appeals staying mandate pending the application to this Court for *certiorari* modified the District Court's order of August 9, 1941 in several respects. For one thing, it authorized the sale of securities by the State Courts. It authorized the State

Courts to proceed with the necessary administrative work looking towards the future distribution of the funds with the exception that no actual distribution should be made. (Tr., pp. 268-270)

The Tennessee respondents respectfully insist that the stay order proceedings in Tennessee looking to distribution of the State deposit was invalid and beyond the power of the Bankruptcy Court in this case.

There is an utter failure of the proof to show any reasonable likelihood of effecting a plan of reorganization which will either (a) require the use of the Tennessee deposit, or (b) by which Tennessee contract holders could be lawfully deprived of their option of obtaining cash out of the Tennessee deposit to the extent of the full amount of their respective claims.

The writ of injunction, when exercised to stay the rights of secured creditors during the pendency of reorganization proceedings, cannot be exercised beyond the dictates of necessity. *Continental-Illinois National Bank & Trust Co.*, v. *Chicago, Rock Island, & Pacific Railway Co.*, 294 U.S., 648, 55 S. Ct., 595, 79 L. Ed., 1110; In Re Nine North Church Street, Inc., 82 F. (2d), 186; *First National Bank of Wellston* v. *Conway Road Estates Company*, 94 F. (2d) 736, (8th C.C.A., *Certiorari* denied by U. S. Supreme Court, 304 U. S., 578, 82 L. Ed., 1541; *Lincoln-Alliance Bank & Trust Company* v. *Dye*, 115 F. (2d), 234.

As regards the deposit in Tennessee (and as for that matter all of the other State deposits) possession was not in the bankrupt at the time of the filing of the petition and the Bankruptcy Court has never acquired either actual or constructive possession of the deposits. In Tennessee, at

least, the sustaining of the bill in the Chancery Court of Davidson County impounding the State deposit prior to the commencement of the proceedings in bankruptcy gave that Court prior and constructive jurisdiction of the *res*, the deposit, and, therefore, the exclusive power to settle the controversies concerning it without being subjected to a stay of such proceedings by the Bankruptcy Court. *Dannel* v. *Wilson-Weesner-Wilkinson Company*, 109 F. (2d) 364, (6th C.C.A.); *Hoehn* v. *McIntosh*, 110 F. (2d), 199, (6th C.C.A.).

The nation-wide jurisdiction conferred upon bankruptcy courts by Section 77-B and in proceedings under Chapter X of the Chandler Act is merely over the property in possession, actual or constructive, of the Debtor or the Bankrupt Court. This summary jurisdiction is essentially in *rem*, and while it enables the Court to issue its process for service outside of its district, in a summary proceeding relating to the *rem*, it does not extend to the persons of non-residents who claim the property adversely. *Warder* v. *Brady*, 115 F. (2d) 89, (4th C.C.A.); *In Re Standard Gas & Electric Co.*, 119 F. (2d) 658 (C.C.A., 3rd); *Kelso* v. *MacLaren*, 122 F. (2d) 867, (8th C.C.A.); *In Re Mt. Forest Fur Farms of America, Inc.*, 122 F. (2d) 232 (6th C.C.A.) (*Certiorari* denied, 314 U. S., 701, 62 S. Ct., 480, 86 L. Ed., 561.)

We respectfully submit that the authorities afford no basis for any power in the United States District Court for the Southern District of Virginia to dispose of the claims of all of the contract holders to the various State deposits summarily as the Court said that it had done and would do if necessary.

## A PETITION MAY NOT BE FILED UNDER CHAPTER X AND SUSTAINED FOR PURPOSE OF LIQUIDATION.

Since petitioners and Securities & Exchange Commission makes the question of jurisdiction turn chiefly on the prospect of a "slow and orderly liquidation," it is necessary to discuss whether or not a plan of liquidation may be a plan of reorganization which will confer jurisdiction upon the Bankruptcy Court. This discussion may be begun by the observation that if Congress had intended to include "liquidation" there was no reason why that word could not have been used in Chapter X, along with "reorganization." *The two terms as commonly understood are contradictory.* And yet, invariably the word "reorganization" is used.

The Court is not authorized to retain jurisdiction unless there is a finding that the petition is filed in good faith, meaning, among other things, that it is not unreasonable to expect that a plan of *reorganization* can be effected. If not so satisfied, it is the duty of the Court to *dismiss* the petition. (Section 144)

If "reorganization" includes "liquidation," why the requirement of a showing that it was not unreasonable to expect that a plan could be effected? A plan of liquidation can always be effected. That is the last resort. If the imperative requirements of Sec. 146 of Chapter X, the heading of which is CORPORATE REORGANIZATION, are to have a natural and reasonable interpretation, liquidation must be excluded. In Sec. 130(6) Congress differentiated between a reorganization and a liquidation.

It is only after a petition has been sustained as having been filed in good faith and it develops that a plan of reor-

ganization cannot be put into effect, that the power is conferred upon the Court to decide between adjudging the Debtor a bankrupt and directing that bankruptcy be proceeded with or dismissing the proceedings altogether. (Section 236 (2)) This may not be done without a *hearing expressly for that purpose* and after notice thereof to creditors.

*The provisions of the Act are not susceptible of the construction that an affirmative finding of a reasonable likelihood of reorganization may be dispensed with by a finding that some kind of liquidation in the Bankruptcy Court would be better than a liquidation in State courts, or otherwise.* The Act permits no escape from the issue which is raised at the very threshold of the litigation—is there a reasonable likelihood of *reorganization.*

The creditors of Fiderity had no notice of any hearing on the question of whether it should be adjudged a bankrupt in the Southern District of West Virginia and an order entered in that Court directing that bankruptcy be proceeded with there. They had notice, actual or constructive, that the Company had filed a petition for reorganization and that there would be a hearing on that question. Section 146 (4) does not extend the scope of the normal hearing on the issue of good faith. Creditors had the right to assume that if this requirement of good faith involving necessarily a reasonable likelihood of effecting a plan of reorganization, could not be met, the mandatory provision of Section 144 that the petition be dismissed would be complied with by the Court.

In the ordinary case, there would be no occasion for the Court looking ahead of the considerations normally to be weighed in determining whether there is a reasonable chance of reorganization. The proponents of reorganization are

bent on showing how the rehabilitation of the company can be effected. Those who feel that it is not to their interest that the company be revived and its business continued adduce facts and arguments to show why reorganization cannot be brought about. If the petition for reorganization is dismissed, the company can ordinarily immediately file in the *same* court a petition to be adjudicated a bankrupt. So, at that stage of the proceeding, there is no necessity for any concern about what will happen to the company if the petition for reorganization is not sustained.

The difference between the ordinary case and this is that unless the petition which has been filed can be sustained as a petition for reorganization under Chapter X, *territorial jurisdiction in the District Court for the Southern District of West Virginia is lacking.*

Section 128 permits the filing of a petition for reorganization under Chapter X with the Court in whose territorial jurisdiction the corporation has had its principal place of business *or* its principal assets for the preceding six months or for a longer period of the preceding six months than in any other jurisdiction.

A petition for an adjudication (in what is commonly called ordinary bankruptcy proceedings) may be filed only where the corporation has had its principal place of business. Section 2, Bankruptcy Act. There is no territorial jurisdiction in the Court merely because the principal assets of the company have been in that jurisdiction for six months.

The principal place of business of the Debtor corporation has always been at Wheeling, West Virginia, in the Northern District of West Virginia. The petition was filed how-

ever, at Charleston in the Southern District on the theory that the deposit with the State of West Virginia constituted the principal assets of the Company.*

If Fidelity is not an insurance corporation and is subject to the Bankruptcy Act, a voluntary or involuntary petition can be filed at Wheeling where its office and all of its records are located. It can be liquidated in bankruptcy without indulging in the sophistry of *calling* a liquidation a reorganization.

Lord Macauley somewhere says that if the admission of the attraction of gravitation were inimical to any considerable pecuniary interest, there would not be wanting arguments against gravitation. Twenty million dollars is enough money to stir men's imagination.

Away with the vauntings of the disinterestedness of the Trustee in Bankruptcy in this case! Let us make it plain. If this Court affirms the decision of the Court of Appeals dismissing this petition for lack of good faith, it means that the present Trustee loses its chance to derive fees from the distribution of the assets of this company. Even if the company is held not to be an insurance company and should be adjudged a bankrupt, the adjudication would be in the Northern District of West Virginia and a Trustee in that District would be appointed. The present Trustee is a corporation organized for profit—not an eleemosynary institution. *How can it claim to be disinterested on the issue of good faith?*

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*It seems to us that this premise is unsound. The deposit in West Virginia constituted a statutory trust fund. Inasmuch as the fund was less than the liabilities secured and the Debtor in this and in no other kind of proceeding, either in the Federal or in the State Court, can take any part of that fund away from the contract holders for whose benefit it is held, without their consent, it does not constitute "assets" of the Debtor.

## "PROBLEMS OF DISTRIBUTION."

### (i) Whether State Deposits Are Solely for Benefit of Local Residents.

Securities & Exchange Commission in its brief says that under the laws of the State of Tennessee it is not clear whether the deposit is solely for the benefit of local residents or for the benefit of all contract holders. It has gotten up an appendix purporting to set out State laws. Through inadvertence one whole paragraph from thte Tennessee statute was not copied in this appendix. The whole statute was printed in our brief filed in the Court of Appeals and was also printed as Appendix "A" to our reply to the petition for *certiorari* in this Court.

We submit that there is no ambiguity in this statute. It clearly provides that the amount of the deposit is to be at no time less than one hundred per cent of the Company's cash or current contract liability on all outstanding investment contracts "sold in the State of Tennessee." It provides that the Commissioner of Insurance and Banking of the State shall hold as Custodian the securities deposited "for the benefit of the holders of the investment contracts coming within the provisions of this Section. The omitted paragraph contains the following provision:

> "Upon discharge in full of all liabilities on all investment contracts sold in the State of Tennessee, and for which such deposit is maintained, the issuer shall be entitled to a release and return of the securities so deposited."

Plainly, this deposit is for the benefit of the holders of all investment contracts sold in the State of Tennessee.

We are constrained to feel that Securities & Exchange Commission has been needlessly perturbed. It overlooks the fact that the deposit in West Virginia was for the benefit of all contract holders wherever situated. The amount of the deposit required in West Virginia was the full amount of the liabilities of the corporation under its contracts, less such additional deposits as it was required to make with respect to contracts sold in other States to the extent that the law of such other States required deposits to be made for the benefit of local contract holders. A reading of the proviso obtained in Section 3 of Article 2, Chapter 33, Michie's 1937 West Virginia Code, on page 71 of the brief of petitioners, Fidelity Assurance Association and Central Trust Company, would clarify this point.

Securities & Exchange Commission, in the appendices to its brief, has seen fit to insert a lot of extraneous matter, contracts, etc., with other State officials that are not in evidence in this case. We, therefore, cannot admit the accuracy or completeness of this extraneous matter.

We do not believe that there is the slightest ground for apprehension that contract holders in other States will claim the benefit of local deposits. All parties, except the Securities & Exchange Commission, understand that non-residents of a State having a local deposit are not beneficiaries of that deposit unless they can claim through some express statutory provision (such as the one in Tennessee securing all contracts *sold* in the State of Tennessee). The exceptional cases where contract holders have changed their residence after the creation of deposit, and such like, fall under the head of *de minimis non curat lex*. See discussion under next head.

## "PROBLEMS OF DISTRIBUTION."

### (ii) Time for Determination of Residence of Contract Holders Entitled to Benefit of Deposits.

It must be admitted that as Securities & Exchange Commission has delineated this question, it takes on an appearance of complexity. Securities & Exchange Commission cites pages 757 to 758 of the transcript. If it had not stopped there but had gone on to page 759, it would have found that Mr. F. J. McNulty, the Secretary of the Company, testified that this was no problem. We quote his testimony as follows:

> "Q. Would there be many states in which there was a considerable number of contract holders who did not buy their contracts or originally in this state but who now own the contracts and reside in those states?
>
> A. Well, if you take, say, two specific states, I would say no, but if you are talking about moving out of one state there might be fifteen or twenty more throughout the United States, but as to a change from one particular state to another particular state, *I don't think the change would amount to very much.*
>
> Q. Then if all that was required under the law in some of those states was that the company only deposit securities that were in funds that were sold in those states, and the debtor decided to withdraw the securities over and above those that were sold only in those states, would there be much withdrawal or would it be a very small figure?
>
> A. Well, I couldn't answer that. I would have to check that. (Tr., p. 759)

Q. You wouldn't be able to answer it?

A. *It wouldn't be a substantial figure*, but it would have to be checked."

## "PROBLEMS OF DISTRIBUTION."

### (iii) Measure of Claims.

The proposition, as we understand it, is that the Federal Court in Bankruptcy at Charleston, West Virginia, must take over the deposits in West Virginia and fourteen other States in order to bring some superior competency to bear on the question of the basis for the determination of the claims of the contract holders entitled to the benefit of the several deposits. Manifestly, if the State deposits are not to be abrogated, the Bankruptcy Court will be bound by the laws of the several States. Certainly there is no Federal rule which can be applied. The Tennessee contract holders will be thoroughly satisfied to let the Tennessee Court determine that question if any is raised. So will the Missouri contract holders. So, we believe, will be the contract holders in all of the other States.

It is admitted that there is no possibility of a surplus in the Tennessee deposit regardless of which of the possible rules may be applied in Tennessee. The entire deposit will be consumed in paying the claims of Tennessee contract holders. What interest do contract holders in other States, then, have in the basis for distribution which is adopted in Tennessee? The West Virginia Court distributing the West Virginit deposit can make its own decision as to the basis for deficiency claims in accordance with the laws of that State. Even though the rule in West Virginia be different from the rule in Tennessee, or one of the other States, we fail to see how it will be more beneficial to con-

tract holders to have the question decided by the Federal Court in Bankruptcy at Charleston than by the Circuit Court of Kanawha County, at Charleston.

We are wondering why it appears strange to Securities & Exchange Commission that there is little inclination among the State officials to litigate these so-called conflicting rights *inter sese*.

## STATES CAN LIQUIDATE DEPOSITS AS WELL AS BANKRUPTCY COURT.

The argument that liquidation in the Southern District of West Virginia at Charleston will result in a more orderly marketing of the securities held in the State deposits does possess a certain plausibility. Here again, however, an examination of the record discloses the speciousness of the argument.

There is not an iota of proof in the record to support the statement that Fidelity's assets are such that there is a serious peril to a maximum realization upon them if each State depositary separately proceeds to immediate liquidation. The record (pp. 799-800) is cited in support of the statement that the situation is plainly one which requires well-timed and skilful liquidation. It is true that the District Court found this, but his finding was not based on any evidence. The evidence cited in support of the statement is the testimony of Mr. Hubert F. Young, a witness for the Debtor and the Trustee, who handled Fidelity's investments.

Mr. Young testified that it would take "quite a while" to liquidate and said that it might drive the market down to the bottom when liquidation started. He expressed more concern, however, about the expense of litigation and the

uncertainty as to what the state of the market would be after years of liquidation.*

This wasteful litigation and postponement of the realization of the present market values of the securities is exactly the thing that the contract holders are so disturbed about and is what these respondents are protesting. (Tr., pp. 799-800.)

The Securities & Exchange Commission makes use of the Trustee's report filed under Section 167 of the Bankrupt Act. It deduces from this report that Fidelity's securities are not readily marketable. (Brief, p. 44.) This conclusion is derived from some kind of system of rating of securities. In candor, these respondents must say that their attorneys are not thoroughly familiar with the basis which was used for this report of the Trustee.** The conclusion that a large part of the securities in Fidelity's portfolio are not readily marketable may not be drawn from the fact that they all have been classified by the Trustee as high-grade securities.

*Almost significant portion of his testimony is:

"Q. If you will assume with us that there are some twenty million dollars of assets in this company, or better than that, which could be be distributed among contract holders on the basis of their cash surrender values at the present time—cash liabilities at the present time—of about twenty-three million dollars, they could get that amount out of liquidation if you just sold them out and distributed the money, couldn't they?

A. I doubt it, after years of liquidation expense and the expense of litigation I don't think they would get anything like twenty million dollars."

(Tr., p. 799)

**The time for filing this report was extended by the Judge until the conclusion of the testimony. The Judge also ruled that those at odds with the Debtor and the Trustee could not cross-examine on the report. That portion of the record where this ruling was made (Tr., pp. 3008-3012) was not included in the designation of the portions of the typewritten record to be printed for the transcript. We are printing this in the Appendix to our brief.

The Report of Securities & Exchange Commission on *Companies Issuing Face-Amount Installment Certificates*, transmitted to Congress on March 13, 1940, states: "The Association has followed a settled policy of investing its funds almost entirely in marketable securities, about ninety per cent of which have consisted of bonds and notes." (Page 96 of Report.)

The Central Trust Company, Trustee in Bankruptcy for Fidelity, under date of July 3, 1941, sent out a circular letter to all contract holders stating that the property of the Debtor was "almost entirely in the form of *liquid assets*, composed of stocks, bonds, and other forms of securities."

The Haskins & Sells audit reports, filed as Exhibits 13 and 14, show the diversification of the investments and the amount of defaulted securities. We do not believe that the amount of bonds in default is abnormal for a port folio such as Fidelity had. For example, many railroad bonds, at the time these audit reports were prepared were in default, are readily marketable and indeed may be termed highly liquid.

Mr. Hubert F. Young further testified as to the character of the investments:

"Q. And has there been any appreciable change in the assets of Fidelity from 1939 to the present time?

A. I would say not an appreciable gain on a percentage basis, no.

Q. As a matter of fact, there has been considerable appreciation in the past two months, hasn't there, in the value of the securities in the port folio?

A. Yes, in certain categories, for instance, railroad bonds.

Q. What do you think about the possibility or probability of appreciation in the value of securities during the next two or three years ahead of us?

A. I think we have an excellent change of appreciation on the type of port folio we have, which consists largely of, you might say semi-speculative bonds and not a great many of the higher grade bonds, which can, I think, go down quite a bit."

(Tr., p. 633.)

This testimony was given in September, 1941. Subsequent events have borne out Mr. Young's prediction. This Court may take judicial knowledge of the fact that prices of the semi-speculative bonds are at a very high level as compared with the averages in past years. There probably has never been a better time than the present to liquidate securities of the type held in the State deposits. No one knows what the future will bring forth. It will take time—too much time—for the several States to complete liquidation. There need be no dread of frenzied dumping of the securities on the market.

The Securities & Exchange Commission was not warranted in stating that the market for these securities is so thin that when they are sold by the States the price will be greatly depressed. The investments are widely diversified. The investment market has recently indicated a practically unlimited capacity to absorb offerings of Government bonds. We have witnessed an almost phenomenal absorption of more than nine billion dollars in a single offering of Government securities. Surely Fidelity's little portfolio of twenty million dollars would not bring about any very marked de-

pressing effect upon the bond market, even if all of the bonds were offered at one time for sale as a whole.

It would seem to us that offerings at different times and in the different sections of the country in which the State deposits are held will be more likely to result in an orderly marketing of the securities than any kind of liquidation that could be attained if the selling is all centered in the hands of one Trustee. Contract holders are afraid that if the latter occurs the liquidation will be stretched out over such a long period of time that no benefit will flow from it in the lifetime of most of them.

## POSTPONEMENT OF LIQUIDATION FOR FURTHER INVESTIGATION OF FIDELITY'S AFFAIRS WILL BE PREJUDICIAL TO CONTRACT HOLDERS.

It is the conviction of the contract holders for whom we speak that the day for probing into Fidelity's affairs has passed. They have in mind an old adage to the effect that there is no use barring the door after the horse has gone.

We are reminded, however, that during the last half decade and longer there has been no hindrance upon investigations and explorations of Fidelity. During that period its books have been open to Securities & Exchange Commission.

Part One of the Report of Securities & Exchange Commission on Investment Trusts and Investment Companies informs us that the investigation of the face-amount certificate companies was commenced on June 30, 1936, when questionnaires were sent out to the companies. It could hardly be said that this questionnaire was limited in its scope. (See Statement in Part One of Report on the Na-

ture, Classification and Origin of Investment Trusts and Investment Companies, p. 8.)

The Commission's Report on Companies Issuing Face-Amount Installment Certificates states that the first public examination into Fidelity's affairs was had on January 28, 1938. In the last month of the year 1938, Securities & Exchange Commission filed its bill in the United States District Court for the Eastern District of Michigan. The particulars of the proceedings against Fidelity, set out in Appendix X to the Report on Companies Issuing Face-Amount Installment Certificates (pp. 197 to 258), indicate that Securities & Exchange Commission was not wholly unfamiliar with the various things that Fidelity had been doing and which constituted the basis for the charge of wrongdoing and fraud. Chapter 3 of that Report, which embraces pages 75 to 120, inclusive, and the other details in Chapter 5 and the appendices relating to Fidelity, set out a considerable amount of detailed information concerning Fidelity.

Not all of the information which Securities & Exchange Commission compiled was set out in its printed report either. A lot more was contained in Fidelity's reply to the Commission's questionnaire. This consisted of several large volumes. These were produced at Charleston during the course of the hearing pursuant to an order made by Court at respondents' request. As we recall, they were about knee-high.

Immediately following the Detroit injunction, there came the suit in the Federal Court in the Northern District of West Virginia to have a Receiver appointed for the Company. During the receivership proceedings two Commission accountants were constantly around and stayed there

until the receivership matter had been determined. (Tes. of Thos. B. Folk, Tr., pp. 939-940.) The Commission has had a perfect legal right to carry on its investigations without interruption since it first commenced nearly seven years ago. More than a year and a half has already passed since Fidelity's books and records came into the hands of the Trustee in Bankruptcy.

The record shows that no single major step has been taken since that time without at least tacit approval of the Commission. The Commission has been consulted on all of the things done to rehabilitate Fidelity, including its conversion into an insurance company. The testimony of Mr. John Marshall, Mr. Fred Risley, Mr. Thomas Foulk, Mr. Raymond Latta and Mr. Arthur B. Koontz makes that perfectly plain. The officers of Fidelity were in practically constant communication and consultation with them.

The insinuation of some sinister motives in connection with the proceedings in the Kanawha Circuit Court and the connection of Mr. Koontz' firm therewith have been put to the forefront as point No. One. It deserves no place in this lawsuit. In this respect we have the assurance that we speak the views of all parties in interest who are opposing this reorganization proceeding: it is a matter of absolute indifference to these parties whether Koontz & Koontz or Townsend & Townsend are to be the attorneys for the liquidators of Fidelity.

It may be said in Mr. Koontz' favor that the record shows with perfect clearness that the appointment of Mr. Ross Thomas, an associate of his firm, as co-Receiver of Fidelity, was not obtained through obreption but was with the full approval of all interested parties who now are disposed to

criticize it. We are afraid that the greatest offense which he committed was, in the eyes of Securities & Exchange Commission, advising State instead of Federal proceedings. The decision that the Company's affiairs should be placed in a receivership in the State Court, however, was openly arrived at and was attended with the greatest deliberation, with full opportunity to all interested parties to express their views. It occurred in a Court located at the place where Mr. Koontz and Mr. Thomas lived and which was the proper and natural forum therefor.

It seems to us that the leaving of the important, nay crucial, question of the rights of contract holders in the State deposits undetermined and magnifying instead trivial and unimportant considerations, such as this one, is "straining at a gnat and swallowing a camel." The inquiry (assuming, as is shown by the record, at times the character of an inquisition) into the relationship of the firm of Koontz & Koontz and Mr. Ross B. Thomas to the Debtor and its affairs, which the defendants steadfastly insisted was extraneous and irrelevant to the issue of good faith in this case, apparently in the mind of the Court was a point of major importance.

During the hearings before the District Judge in this case, altogether several hundred pages of testimony were taken, over the objection of respondents that it was irrelevant, about nothing except the amount of fees which Koontz & Koontz had been paid by Fidelity over a ten-year period. Respondents feel compelled to state that the District Judge, sitting in a Court two hundred miles away from the home office of the Company where all the company's records were located, and in a Federal District outside the District in which the receivership suit had been brought in 1939, mani-

fested an inclination to allow the attorneys for the Trustee whom he had appointed an opportunity to conduct an "exploration" that was very far afield. This matter was the subject of an exchange of letters between the District Judge and the Judge in the State Court. (Original Transcript of Record, pp. 131-133.)

We feel that it was very unfortunate that the rights of contract holders in Tennessee and in the other States where deposits are being held should have depended in the slightest degree upon such a collateral inquiry. The jurisdiction of a court in bankruptcy to entertain this proceeding for reorganization of Fidelity most certainly should not turn upon weighing the ethical standards of Koontz & Koontz as against those of Townsend & Townsend.

There is an ancient maxim "*Executio juris non habet injuriam*," meaning "the law will not in its executive capacity work a wrong." A lack of integrity or competence to make decisions or to execute powers is never assumed in regard to Courts in this land. On the other hand, it is a fundamental assumption that Courts are sound and just.

A Federal Court would, therefore, not be warranted in assuming that a State Court would in its executive capacity work a wrong. If we assume, for the sake of argument, that the record in this case warrants the conclusion that it would not be to the best interest of creditors of Fidelity Assurance Association, for Mr. Ross Thomas to continue as a Receiver in the State Court, this works no disqualification of the State Court itself to serve the interest of creditors and in such proceedings to be guided solely by the dictates of justice.

The personal integrity of Mr. Ross Thomas is unquestioned. If there is any unsuitability on his part to be a Receiver in the State Court, there is no ground for this Court making any supposition that a proper and suitable correction will not be made by the State Court whenever its attention is challenged to the need therefor.

Judge Bouchelle, in his letter to Judge Moore, stated that he would not hesitate to perform his duty.

Securities & Exchange Commission, at page 33 of its brief, made reference to an indictment against Mr. Arthur Koontz. We have since been advised that the Office of the Solicitor-General admits that this was injected in the brief though a mistake. But still it is in there. We cannot refrain from expressing the opinion that Securities & Exchange Commission when it inserted this matter not only struck below the belt but went outside the record.

Something must be said about this attempt to weight the balances on the side of the Bankruptcy Court with scandal. The indictment referred to was obtained by Securities & Exchange Commission in Detroit, in December, 1941, (just before the statute of limitations would have run against acts committed prior to the filing of the injunction suit in Detroit) after the hearings in this case had been finished. Before the District Judge rendered his decision in this case these respondents made a motion to have it made part of the record for the purpose of showing that Fidelity Assurance Association, the Debtor, was under indictment. We thought that this was relevant on the question of whether or not there was enough vestige of good will left to justify any expectation that contract holders would consent to send good money after bad. The District Judge overruled our motion and excluded the indictment.

The chief basis for the indictment seems to be a lot of the matter set forth in the report on Fidelity in the Report on Companies Issuing Face-Amount Installment Certificates. We believe that all the material facts were either printed in this report or known to Securities & Exchange Commission when it filed the complaint and obtained the injunction in Detroit, in December, 1938.

We are reluctant to set ourselves up as critics of other men's conduct. It does seem to us, however, that before urging this matter as a ground of disqualification of the West Virginia State Courts to serve the best interest of contract holders, Securities & Exchange Commission should give a thought to consistency. The Detroit injunction which Securities & Exchange Commission obtained on December 22, 1938, was granted by reason of misconduct. It enjoined not only Fidelity, but its officers, directors, agents, representatives and employees, from engaging in and continuing such practices which were alleged to be fraudulent. All of these persons were ineligible to serve or act in the capacity of officer or director, by virtue of the provisions of Section 9 (a of the Investment Company Act of 1940. According to the testimony adduced in this case by the Commission, Fidelity became a registered investment company under the Act, by giving notice prior to January 1, 1941, of its intention to register.

Securities & Exchange Commission has made no objection to any of them continuing to act. Its representatives did not join the respondents in protesting the ruling of District Judge granting express permission to all of these ineligible persons, to have another meeting *while the hearings were in progress*, for the purpose of ratifying the previous action of

the directors authorizing the filing of the petition in this case. Mr. Koontz was not one of these persons.

It would seem that if the Kanawha Circuit Court of West Virginia could not serve the best interest of the contract holders of Fidelity because Mr. Koontz' firm had been appointed attorneys for the Receivers and one of his associates, Mr. Thomas, was a co-Receiver, neither was it proper for Fidelity to employ them before the receivership suit. Nor were Mr. Koontz and Mr. Thomas by themselves. On the same ground, the directors and officers—Mr. John Marshall, Mr. Fred Small Risley, Mr. A. L. King, Mr. Carroll D. Evans and Mr. Howard E. Reed—named in the indictment ought to have been disassociated from the company.

Securities & Exchange Commission, as is shown by this record, worked very closely with all these men after the Detroit injunction. If it were wrong for Mr. Koontz and Mr. Thomas to have anything to do with the Company's affairs after the receivership, it was wrong for them and the officers and directors mentioned above to be connected with the company after December, 1938, and especially was it improper (unless Fidelity was an insurance company) for them to continue their connection after January 1, 1941, when the Investment Company Act became operative.

We think that Mr. Koontz and Mr. Thomas are honorable men. For that matter, we think that all of the gentlemen who testified at the hearing of this case are honorable men. As the Securities & Exchange Commission admits (Brief, p. 40), except for a brief period in 1937, Fidelity has been insolvent continuously since 1933. They were all fighting to save the contract holders from loss. There was a constant hope that some tide would lift Fidelity off the rocks.

One cannot read this record without being impressed with the fact that Mr. Koontz was the man on whom they all leaned in the darker hours. Even Mr. John Marshall, Sr., who, by the way, was Chairman of the Board of Directors and whose firm was general counsel for the company (Tr., p. 410), not only held Mr. Koontz in high esteem but depended on his support and guidance. (Original Tr., pp. 1140-1143)

When Fidelity could not comply with the Investment Company Act and it became apparent that some step of a rather drastic nature must be taken to avert disaster, it was Mr. Koontz who for several years past had been trying to raise new money for the company, that outlined before the Securities & Exchange Commission the plan of voluntary reorganization in the State Court which seemed then to all concerned to be the most feasible. We can see that Mr. Koontz had no choice but to stick by his friends. The fact that his firm was attorney for the Receiver was then no doubt regarded by Mr. Marshall, Mr. Messick and all of the other gentlemen as an asset and as furnishing the most likely presage of success.

There is nothing to indicate that Mr. Koontz and Mr. Thomas were actuated by any motive other than the welfare of the contract holders whose savings were tied up in this embarrassed company. Must we presume that they were concerned about stifling any investigations or concealing any liability after Securities & Exchange Commission had made a most thorough and searching investigation into the affairs of the Company and had printed its findings and made a report to Congress and to the public? Securities & Exchange Commission, in the year 1943, more than six years after its investigation of this company's affairs

was commenced, now says that the case ought to be in bankruptcy because there might be liability on the part of Mr. Koontz if there is substance to its charges.

Section 167 (4) of the Bankruptcy Act imposes the duty on the Trustee to report any facts ascertained by it pertaining to fraud, misconduct, mismanagement and irregularities and any causes of action available to the State. The Trustee in this case, which will not be charged with any misprision, so far as Mr. Koontz is concerned, has made no report against him.

We are advised that the Trustee, on April 13, 1942, filed Part Two of its report due to be made under Section 167 of the Bankrupicy Act. The Trustee stated in this report in substance that it was making a detailed study of the alleged irregular practices of former management rendering participants therein liable in damages but was unable to make detailed report concerning same. No further report has been made since that date.

In short the Trustee, after a year and a half, aided by all of the data which Securities & Exchange Commission had accumulated during the previous five years, is unable to make up its mind whether or not it has a lawsuit. The fact that jurisdiction was unsettled was no hindrance to the performance of its duty in this respect. Let us suppose that it should finally decide that it has a probable cause of action. How many years will the case be in the courts before it is determined?

But if there need be further investigation it doesn't depend on a decision in this case that the good faith requirement of Chapter X may be satisfied by a showing that the insolvent debtor can be liquidated in the Bankruptcy Court.

If liquidation occurs in the State Court proceedings, would there be interference with an investigation by Securities & Exchange Commission? If a cause of action exists, couldn't it be as effectually prosecuted in a straight bankruptcy proceeding at Wheeling, in the Northern District of West Virginia, where the office of the company and its records are located?

## INAPPLICABILITY OF DOCTRINE OF MARSHALING —FIFTH AMENDMENT.

Apparently what the Securities & Exchange Commission has in mind when it speaks of marshaling the assets of Fidelity is an attempt to redistribute all the assets on the basis of separate reserve funds for the various series of contracts outstanding (Brief, p. 38) It is insisted that a prerequisite to the accomplishment of this Herculean task is bringing all of the assets into one forum.

It will have to be conceded that, if this were otherwise possible (and the evidence clearly shows that Fidelity did not keep separate records on the several funds until the latter years of its existence and the expert employed by it, Mr. Latta, after working eight months concluded that it couldn't be done—Tr., p. 1072), it would only be accomplished through an abridgement of the rights of contract holders having the security of the State deposits.

The argument is based upon a misapprehension of the doctrine of marshalling. The doctrine may not be invoked so as to impair the remedy of the holder of a prior lien or deprive a litigant of a contract right, nor even to put his claim in jeopardy nor to subject him to unreasonable delay in the enforcement of his claim.

In *Merrill* v. *National Bank of Jacksonville*, 173 U. S., 131, 19 S. Ct. Rep., 360, 43 L. Ed. 640, this Court approved a rule of the Chancery Court to the effect that:

> " . . . as the trust created by the transfer of the assets by operation of law or otherwise is a trust for all creditors, no creditor can equitably be compelled to surrender any other vested right he has in the assets of his debtor in order to obtain his vested right under the trust. It is true that, in equity, a creditor having a lien upon two funds may be required to exhause one of them in aid of creditors who can only resort to the other, but this will not be done when it trenches on the rights or operates to the prejudice of the party entitled to the double fund. Story, Eq. Jur. (13th ed.) Sec. 633; Re Bates, 118 Ill. 524 (59 Am. Rep. 383). And it is well established that in marshalling assets, as respects creditors, *no part of his security can be taken from a secured creditor until he is completely satisfied*. Leading Cases in Equity, White & Tudor, vol. 2, pt. 1, 4th Am. Ed., pp. 258, 322."

In *Sowell* v. *Federal Reserve Bank*, 268 U. S., 449, 45 S. Ct. Rep., 528, 69 L. Ed., 1041, Mr. Justice Stone delivered the opinion of the Court, saying:

> "The equitable doctrine of marshaling rests upon the principle that a creditor having two funds to satisfy his debt may not, by his application of them to his demand, defeat another creditor, who may resort to only one of the funds. The debtor may not ordinarily invoke the doctrine, for by doing so he would disregard the express provisions for his contract on which the creditor is entitled to rely. The plaintiff in error is bound to pay his obligation, according to its tenor. He

cannot deny his own contract merely because his creditor has acquired other rights with which he may satisfy his debt. . . ."

The creditors in the case at bar having the security of the State deposits do not have two funds from which to obtain satisfaction of their debts. In the two or three States which have apparently one hundred per cent security, they have only one fund. In all of the other States, as in Tennessee and Missouri, that one fund is not sufficient. Neither the insolvent debtor, Fidelity Assurance Association, nor the Trustee in Bankruptcy, standing in its shoes, has any right to invoke the doctrine. Neither does any creditor have that right. None of them have any right to take away or abridge to the slightest extent the security which the Company put up in those States requiring deposits as a condition to the grant of a license to do business.

*A fortiori* jurisdiction does not exist in the United States District Court for the Southern District of West Virginia for the purpose of bringing all of the securities in the State deposits into that Court to enable an exploration or investigation to be made, with a view of some kind of re-shuffling of the deposits.

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The Bankruptcy Act is subject to the Fifth Amendment. An Act of Congress which is retroactive in terms and purports to take away the rights of a mortagee in specific property is violative of the Fifth Amendment. *Louisville Joint Stock Land Bank* v. *Radford*, 295 U. S., 555, 55 S.Ct., 854, 79 L. Ed., 1593, 97 A.L.R., 1106.

Although a Bankruptcy Court, once jurisdiction has been acquired, may direct the marshaling of all liens upon prop-

erty forming a part of the bankrupt's estate, power to disregard the property rights created by State law is lacking. *Wright* v. *Union Central Life Insurance Company*, 304 U. S., 502, 58 S. Ct., 1025, 82 L. Ed., 1490.

After the States, in valid exercise of the police power, had enacted legislation requiring companies doing this kind of business to maintain deposits for the protection of its citizens, there was no power in the Federal Congress to abridge the vested property rights of contract holders in the deposits. As we have pointed out, Investment Company Act is prospective. Congress purposely refrained from enacting any legislation affecting the deposits made up to the effective date of the Act.

The argument of Securities & Exchange Commission that this Court should reverse the decision of the Fourth Circuit Court of Appeals and hold that the Bankruptcy Court has jurisdiction for the *avowed* purpose of abridging these vested rights of contract holders is tantamount to the insistence that through judicial fiat this Court may exercise a power which is denied Congress by the Constitution. Authority is not lacking for the view that the Fifth Amendment prohibits the judicial, as well as the legislative branch of the Federal Government, from depriving any person of his property without due process of law.

> "Individual citizens require protection against judicial action as well as legislative; and perhaps the question, what constitutes due process of law, arises as often when judicial action is in question as in any other cases. But it is not so difficult here to arrive at satisfactory conclusions, since the bounds of the judicial authority are much better defined than those of the

legislative, and each case can generally be brought to the test of definite and well-settled rules of law."

*Cooley's Constitutional Limitations* (8th Ed., Vol. II, p. 845.

The judicial authorities of a State are bound by the prohibition of the Fourteenth Amendment. *Chicago, etc., Railroad Company* v. *Chicago*, 166 U. S., 226, 17 S. Ct., 581, 41 L. Ed., 979.

The very first order entered by the District Judge in this case approving Debtor's petition directed the State receivers to turn over all funds in their possession. This was on June 6, 1941. This was followed by the turn-over order entered on June 10, 1941. Without any notice or hearing, all custodians of the State deposits were ordered to surrender the deposits to the Trustee in Bankruptcy. (Tr., p. 11)

None of the custodians of the State deposits or the State Court Receivers, except the West Virginia State Court Receiver, complied with the order. Finally, perceiving that the order was invalid, on motion of the Central Trust Company, these orders were modified so as to permit the State custodians and State Receivers to retain the securities and merely to enjoin them from disposing of them. (Order entered August 9, 1941, Tr., pp. 102-114)

Although Congress withheld from the Bankruptcy Court summary jurisdiction over these deposits, Securities & Exchange Commission is now asking this Court to interpret Chapter X of the Bankruptcy Act in such manner as to supply this power to the Bankruptcy Court. A decision that a liquidation of Fidelity under Chapter X proceeding in the United States District Court for the Southern Dis-

fric̈t of West Virginia, where a petition in ordinary bankruptcy could not be filed by or against it, in order that the State deposits may be "marshaled" in that Court in the way in which Securities & Exchange Commission so strenuously insist should be done, would amount to a validation by this Court of the summary turn-over order made by the District Judge on June 10th. The very next thing that would happen would be a renewal of the order of June 10th in the District Court pursuant to the power which the Court reserved in the modifying order of August 9th. (Tr., p. 113) Petitioners and Securities & Exchange Commission make no effort to conceal their intentions. Their argument is grounded upon the presumed inadequacy of ancillary proceedings. They base their appeal upon the necessity of bringing all of the State deposits into the Bankruptcy Court under compulsion.

*We respectfully insist that an interpretation of Chapter X of the Bankruptcy Act so contrary to any that has heretofore been given it, under all the attendant circumstances, would be so grossly arbitrary and unreasonable as to be incompatible with the fundamental law and a denial of due process to contract holders claiming the security of the State deposits.*

## CONCLUSION.

If the case were to be settled as a problem of dialectic concerning the powers and jurisdiction of the Bankruptcy Court, respondents, by reason therefor, would not be disquieted. But the ends of justice will not be subserved merely by the solution of abstract legal problems.

In the final analysis the question in the case is not what the Bankruptcy Court *may* do, but what it *ought* to do.

Can any possible benefit flow to the contract holders from the continuation of this proceeding? Who will benefit? When will they derive the benefits? How much will they benefit? These are the practical questions in the case that must not be sidetracked for legal theories.

Eighty thousand contract holders are not apathetic. They are not interested in fine legal points which lawyers excogitate. Scattered in twenty-nine States with an average claim of $250.00 each, they could not afford to employ the necessary accountants and lawyers to take part in Court hearings in a distant State. They rely upon their common sense, the most infallible of counsellors, which tells them that this company is *through*, and while reorganization may be talked about, it will never be accomplished.

They were induced to put money in the company because they thought it was secured by the deposits. Everyone assured them of that. They had the sales prospectuses of the company, the salesmen's representation, the assurance of their own State insurance or securities department, and if they consulted them, the advice of their lawyers. Also, if they came in after the news of the Securities & Exchange Commission's intervention had been disseminated, they felt

that they had an additional guaranty that the plan was safe and sound and in conformity with the laws of the land.

There are in array against them the company itself, the Trustee appointed by the Court in Charleston, and Securities & Exchange Commission. The case which they insist for not only goes beyond settled principles of equity in bankruptcy, but is jarring upon the American sense of freedom, order and justice.

The fact that contract holders are entitled to look to the State deposits for their protection is too firmly embedded in the minds and consciousness of too many people to be uprooted by the eccentric premises which have been advanced. It tends to cast reproach upon too much that has been done in good faith, over so long a period of time, and by so many honest men. The striking down of the State deposits can only be purchased by paying a high price in American honor—the company was wrong, the officials were acting in bad fath, State laws were no good, State officials were acting in bad conscience. And what of the position of Securities & Exchange Commission which permitted State deposits to be created in this manner.

Liberty-loving Americans who cherish their institutions are appalled at the idea that a Bankruptcy Court would say: "Your State regulation has been no good, *surrender* everything that you have counted on and come up to Charleston, West Virginia, and prove, if you can, what yours rights are." They prefer to think that it is in keeping with the principles which Americans hold high and sacred that they be privileged to say, "You sent these securites to us. We accepted them in good faith. We assumed there was the same measure of good faith on your part. We thought that you knew what you were doing. Our Courts are open

and they are just. If you conceive that there has been error come where we are and where the property is located and prove it. Be assured that we want nothing that we cannot keep in the clearest conscience."

It is not difficult to see the delay, the expense and the hardship on contract holders, which an affirmance of the decision of the District Judge would entail. First, the entire Twenty Million Dollars of securities held in the State deposits would have to be surrendered to the Trustee in Charleston just as it was ordered to be done on June 10, 1941. Since few individual contract holders can afford to employ attorneys and accountants and incur the expenses of attending hearings there, groups of them will have to organize protective committees. After hearings almost innumerable, the Court will rearrange the contract holders according to some scheme. The Trustee already contends that no plan of liquidation can be worked out until this has been done. Then will follow the flock of appeals to the Circuit Court of Appeals and from thence the case will wind its tedious way back to this Court.

If this happens, many of us might as well plan to devote the next decade to this muddle-clearing. There will be the annual costs in administrative expenses of the estate amounting to $150,000.00, the risk of depreciation or decline in securities, the possible liability for a large amount of additional income taxes that will accrue if the contention of the Federal government is sustained that the estate must pay Federal income taxes on all the income from the securities held in the State deposits, the compensation to attorneys for the contract holders and protective committees, and what will not be least of all the over-all fees on the whole Twenty Million Dollar estate that may be

allowed to the Trustee and its attorneys after the deposits have been surrendered and the *slow* liquidation is conducted at Charleston. The contract holders' burden will not be eased, whether the plan of payment be on a pay-as-you-go or pay-as-you-stay basis.

There are contract holders who were laying aside their money to pay for the education of their children. There are others who put aside the savings for sickness, marriage and old age. Many of them need their money now. What untold amount of inconvenience and suffering will follow in the wake of the device that is formed to liquidate the assets as slowly as necessary and as expeditiously as is possible under such circumstances!

We submit again, as we have ever done, that the underlying issue is [redacted] of *good faith*. Debtor's case should be scrutinized with extreme care lest the Federal Courts unwittingly be used as an instrumentality for breaking faith with many thousands of humble persons who are as sheep dumb before their shearers.

Respectfully Submitted,
WELDON B. WHITE,
FYKE FARMER,
RUDOLPH K. SCHURR.

The State of Tennessee, through its Attorney-General, concurs in the foregoing brief and also in the joint *amici curiae* brief filed on behalf of the other States.

ROY H. BEELER,
*Attorney-General of the State of Tennessee*
NAT TIPTON,
*Assistant Attorney-General of the State of Tennessee*

## APPENDIX A

Reports sent to Insurance Commissioner of Tennessee, filed as Exhibit 77.

July 25, 1939

Hon. James M. McCormack, Commissioner
Department of Insurance and Banking
State of Tennessee
Nashville, Tennessee

Dear Sir:

In accordance with arrangements previously made, we are enclosing a certificate showing the cash liability as of June 30, 1939 on all contracts held by residents of your State.

We now have on deposit securities with a par value of $161,000.00 and a market value of $170,896.88 as of June 30, 1939.

Very truly yours,
F. J. McNulty
Assistant Secretary

FJMcN CMH

### FIDELITY INVESTMENT ASSOCIATION
JUNE 30, 1939

CASH LIABILITY—STATE OF TENNESSEE

| *Account* | *Net Cash Liability* |
|---|---|
| Income Contract | $ 311.59 |
| Special Annuity Contract | 34,488.79 |
| Special Annuity Contract, Maturity and Retirement | 18,233.51 |
| Income Reserve Contract, Series "A" | 385.00 |
| Income Reserve Contract, Series "B" | 69,223.29 |
| Income Reserve Contract, Series "B" Maturity and Retirement | 24,469.17 |
| Income Reserve Contract, Series "D" | 408.00 |
| | $147,519.35 |

STATE OF WEST VIRGINIA
COUNTY OF OHIO

A. L. King and W. J. Gribbin, after being first duly sworn, depose and say that they are Vice President and Auditor respectively, of the Fidelity Investment Association, and further state that the foregoing statement of cash liability on all contracts held by residents of the State of Tennessee at June 30, 1939 is true and correct to the best of their knowledge and belief.

.....
Vice President

.....
Auditor

Subscribed and sworn to before me, a Notary Public, this 25th day of July, 1939

.....
Notary Public
My commission expires December 9, 1939

March 20, 1940

Hon. James M. McCormack, Commissioner
Department of Insurance and Banking
State of Tennessee
Nashville, Tennessee

Dear Mr. McCormack:

As indicated in Mr. Young's letter to you dated March 7, 1940, we are enclosing the Certificate of Liability covering all contracts held by residents of the State of Tennessee, as of February 29, 1940.

Our records indicate that the securities on deposit for the protection of these contract-owners, as of February 29, 1940, had a par value of $161,000; book value of $167,163.30; and a market value of $168,415.00.

Mr. Young is handling the arrangements concerning an additional deposit and the securities will be sent to you after final approval by your Department.

Very truly yours,
F. J. McNulty
Secretary

FJMcN/CMH

**FIDELITY INVESTMENT ASSOCIATION**

February 29, 1940

CASH LIABILITY—STATE OF TENNESSEE

| *Account* | *Net Cash Liability* |
|---|---|
| Income Contract | $ 408.12 |
| Special Annuity Contract | 28,184.21 |
| Special Annuity Contract, Maturity and Retirement | 19,323.67 |
| Income Reserve Contract, Series "A" | 460.00 |
| Income Reserve Contract, Series "B" | 110,617.64 |
| Income Reserve Contract, Series "B" Maturity and Retirement | 12,641.54 |
| | $171,635.18 |

State of West Virginia
County of Ohio

A. L. King and W. J. Gribben, after being first duly sworn, depose and say that they are Vice President and Auditor, respectively, of the Fidelity Investment Association, and further state that the foregoing statement of cash liability on all contracts held by residents of the State of Tennessee at February 29, 1940 is true and correct to the best of their knowledge and belief.

.....
Vice-President

.....
Auditor

Subscribed and sworn to before me, a Notary Public, this 19th days of March, 1940

.....

My commission expires October 13, 1941

October 19, 1940.

Mr. T. E. Miles
Deputy Commissioner
Department of Insurance & Banking
Nashville, Tennessee

Dear Mr. Miles:

In accordance with arrangements previously made, we are enclosing a certificate indicating our cash liability in the State of Tennessee as of September 30, 1940. Included in this certificate is a statement as to the market value of securities on deposit as of that date.

For your convenience in checking the market value of the securities, we are enclosing an itemized list showing the par value, description and the market value, as of September 30, 1940. The market quotations, as shown on the attached list, were furnished to us by the firm of Minsch, Monell and Company, Incorporated of New York City.

Very truly yours,

F. J. McNulty
Vice President and Secretary

FJMcN:CSH

## FIDELITY INVESTMENT ASSOCIATION

SEPTEMBER 30, 1940

### CASH LIABILITY—STATE OF TENNESSEE

| *Account* | *Net Cash Liability* |
|---|---|
| Income Contract | $ 3,540.02 |
| Special Annuity Contract | 18,233.79 |
| Special Annuity Contract, Maturity and Retirement | 15,462.31 |
| Income Reserve Contract, Series "A" | 594.50 |
| Income Reserve Contract, Series "B" | 119,054.10 |
| Income Reserve Contract, Series "B" Maturity and Retirement | 16,987.12 |
| Income Reserve Contract, Series "D" | 642.00 |
| | $174,513.84 |

Market Value of Securities on deposit at September 30, 1940, $187,206.25

State of West Virginia
County of Ohio

A. L. King and F. J. McNulty, after being first duly sworn, depose and say that they are Vice President and Secretary, respectively, of the Fidelity Investment Association, and further state that the foregoing statement of cash liability on all contracts held by residents of the State of Tennessee at September 30, 1940, and the market value of securities on deposit as of the same date, are true and correct to the best of their knowledge and belief.

..... Vice President

..... Secretary

Subscribed and sworn to before me, a Notary Public, this 17th day of October, 1940

.....

My commission expires October 13, 1941

## SECURITIES ON DEPOSIT WITH STATE OF TENNESSEE AS OF SEPTEMBER 30, 1940

| *Par Value* | *Name and Description* | *Market Value* |
|---|---|---|
| $ 22,000 | Fayette County, Tennessee, Road & Bridge Issue No. 2, 4 3/4s 1958 | $ 23,100.00 |
| 1,000 | Marion County, Tennessee, School 4s 1964 | 940.00 |
| 4,000 | Marion County, Tennessee, School 4s 1965 | 3,760.00 |
| 4,000 | Marion County, Tennessee, School 4s 1966 | 3,760.00 |
| 4,000 | Marion County, Tennessee, School 4s 1967 | 3,760.00 |
| 15,000 | McNairy County, Tennessee, County Ref. 3½ -5s 1962 | 12,150.00 |
| 19,000 | Morgan County, Tennessee, Gen. Ref. 3-4½s 1955 | 13,870.00 |
| 48,000 | New York City, Corporate Stock of, Gen. to Provide for Supply of Water 3½s 1976 | 50,760.00 |
| 15,000 | Rhea, County of, Tennessee, Gen. Indebtedness 6s 1965 | 12,000.00 |
| 15,000 | Roane, County, Tennessee, Ref. "A" 5½ 1956 | 12,000.00 |
| 3,000 | Sheffield, City of, Alabama, Water Revenue 4½s 1952 | 3,000.00 |
| 5,000 | Sheffield, City of, Alabama, Water Revenue 4½s 1953 | 5,000.00 |
| 2,000 | Sheffield, City of, Alabama, Water Revenue 4½s 1954 | 2,000.00 |
| 3,000 | Sheffield, City of, Alabama, Water Revenue 4½s 1962 | 3,000.00 |
| 35,000 | United States of America Treasury 2 7/8s 1960/55 | 38,106.25 |
| $195,000 | | $187,206.25 |

## APPENDIX B

## RULING OF COURT ON OCT. 6, 1941, CONCERNING TRUSTEE'S SECTION ONE SIXTY SEVEN REPORT. (PAGES 3008-12 OF TYPEWRITTEN RECORD.)

"MR. PALMER: This is the day in which the trustee was to have filed its report, and I am wondering if copies are available for counsel at this time. If they are available I would like the opportunity to examine them.

THE COURT: I have already ruled that the trustee's report is not connected in any way with this proceeding in connection with any cross-examination.

MR. PALMER: I understand.

(There was a discussion off the record.)

MR. FARMER: I don't care to amplify what the record already shows, only as the matter came up last week, the first day, I stated my insistence that the trustee ought to make its report as to the desirability of reorganization. Your Honor made the same ruling last week that you made today. I don't care to press the matter further, but I wish to state an exception.

THE COURT: You were talking about the—

MR. FARMER: I was talking about the trustee.

MR. T. C. TOWNSEND: I understood in connection with the trustee's report, your Honor, that your Honor had very definitely ruled that report would not be considered in connection with the present proceedings.

THE COURT: That is correct.

MR. T. C. TOWNSEND: And the Court hasn't altered that ruling. Now, I do want to say that it is my information that there will be a partial report under Section 167 to be filed with

the Court probably late today or tomorrow, and the trustees are continuing to work on an additional and further report; and in that connection, I want to say also that at the time the Court fixed October 6 as the date for the making of the report of the trustee, nobody anticipated that the present proceedings would continue for the length of time they have been drawn out, and in view of that, the Court probably ought to extend the time, in his discretion, for the trustee to make an additional and further report to anything that I might have to report at this time.

MR. FARMER: We object to any extension of time, because we think that no sufficient excuse has been offered for the failure of the trustee to have the report here and available for all the parties interested in this hearing.

THE COURT: I will extend the time to November 5, 1941, and ask the trustee to make as complete a report at that time as may be done, and if the report cannot be made completely at that time, then we will take up the question of further extension.

MR. PALMER: In that connection, will the trustee make its partial report now for the use of those who desire to make use of it, and also the time for those who wish to file a plan for the trustee extended from November 6 until December 5. At the present time, the Court's ruling is that on October 6 the trustee shall file its report, and those who desire to file a possible plan of the trustee will have a month to study it and submit their findings on November 6; and I am suggesting to the Court, if it is agreeable to the trustee, if they have this partial report, to submit it to those counsel interested, and then a further extension of time be granted for the complete report, and then an extension of time be granted after that complete report for a study of it, so that proper plans can be offered the trustee.

THE COURT: That would depend on just what character this partial report is. If the partial report is such that it can include all the necessary information that these persons would need who expect to submit the plan, then I don't see any reason for extending the time. If not, then I would extend the time, and we

can probably tell more about that when we hear just what the scope of the present report is.

MR. PALMER: I understand that the present report will be made available to counsel not for cross-examination in this case, as the Court ruled, but I mean available to counsel for their information.

THE COURT: I don't know whether it is available in the sense that there are copies made for all counsel or not."

# SUPREME COURT OF THE UNITED STATES.

No. 319.—October Term, 1942.

Fidelity Assurance Association, a corporation, Debtor, et al., Petitioners,
*vs.*
Edgar B. Sims, Auditor of the State of West Virginia, etc., et al.

On Writ of Certiorari to the United States Circuit Court of Appeals for the Fourth Circuit.

[April 5, 1943.]

Mr. Justice Roberts delivered the opinion of the Court.

This case presents important questions concerning the construction of Chapter X of the Bankruptcy Act.[1] Many states of the Union are interested because of the asserted incidence of its provisions upon state laws and rights thereby created. A number of state officers[2] are parties.

Fidelity Assurance Association, a West Virginia corporation, filed its petition for reorganization in the District Court for Southern West Virginia. The Judge made an order approving the petition as properly filed. He also entered orders enjoining state officials from dealing with property held by them.[2]

State banking and insurance commissioners and state court receivers answered, asserting that the debtor could not avail itself of the Act because it was an insurance company[3] and, in any event, the petition was not filed in good faith, as the phrase is defined in § 146(3)(4) of Chapter X.[4] The Securities and Exchange Commission intervened at the request of the District Court. After trial of the issues, the court formally approved the petition and overruled the motions to rescind the decrees granting injunctions.[5] The Circuit Court of Appeals reversed.[6]

[1] Act of June 22, 1938, 52 Stat. 840, 883; 11 U. S. C. §§ 501-676, incl.

[2] An appeal was taken from the District Court's refusal to rescind the orders. The Circuit Court of Appeals refused to disturb them at that stage of the proceeding. Sims v. Central Trust Co., 123 F. 2d 89.

[3] Act of July 1, 1898, c. 541, § 4, 30 Stat. 547, as amended, 11 U. S. C. § 22.

[4] 11 U. S. C. § 546.

[5] 42 F. Supp. 973.

[6] 129 F. 2d 442.

The debtor was organized April 11, 1911, under the name of Fidelity Investment and Loan Association. Its corporate purposes were enlarged in 1912 to include the soliciting and receiving of payments on annuity contracts. Thereby it became subject to the provisions of Art. 9 of Ch. 33 of the Code of West Virginia,[7] relating to the selling of annuity contracts and, as therein provided, to the supervision of the Auditor, as ex-officio Insurance Commissioner of the State.

From December 1912 to the close of 1940 the company's business was the selling of investment contracts and for this purpose it was licensed in many states. It altered its contracts from time to time but in general they consisted of certificates evidencing the agreement of the purchaser to make specified periodic payments and the company's agreement that upon the expiration of a stipulated term it would return to him in instalments a sum designated as the face amount, or pay a lump sum less than the face amount.

During the six years preceding December 30, 1940, the debtor sold a contract having a collateral insurance feature provided by a blanket policy procured by Fidelity from Lincoln National Life Insurance Company. Approximately seventy-five per cent. of the contracts issued after 1934 contained this feature.

It will be seen that the business was essentially the conduct of a compulsory savings plan. The interest paid a certificate holder was at a low rate and the penalty for failure to keep a certificate alive was heavy. The expense of selling the contracts was inordinately high and, in spite of a large volume of sales, the company was constantly falling behind and suffering serious losses.

The present Insurance Commissioner of West Virginia took office in 1933. It was his duty to require and approve the deposit with the State Treasurer of bonds and securities to be held in trust for the benefit of the company's West Virginia contract holders to an amount equal to the cash liability to them; to require a similar deposit in trust for the benefit of holders located in other states to the extent that the laws of such states did not provide for a deposit equal to, or greater than, that called for by the laws of West Virginia. Shortly after taking office, the Commissioner dis-

[7] Michie's W. Va. Code 1937, p. 1204 ff. This Article was repealed by chapter 46, §12, Acts of West Virginia, 1941, effective ninety days from March 8, 1941, but this fact is irrelevant to any issue in this case.

covered that the company was insolvent. There is a long history of negotiations and requirements, extending almost to the time of filing the petition, in an effort to restore it to a solvent condition.

The company was at one time licensed in twenty-nine states each of which had laws regulating its business; fifteen required a deposit of approved investment obligations with some state official to secure payment of outstanding contracts held by residents; the remainder had no such requirement, but the contracts sold in these states were secured by the deposit made with West Virginia.[8] As of the date of the filing of the debtor's petition, the deposits made with various states, including West Virginia, amounted, according to the debtor's figures, to $20,056,680.27 against a net reserve liability of $24,221,651.36. In addition, the company had securities not deposited anywhere valued at $556,467.51, most of which were ineligible for deposit under the laws of any state, and $500,000 in cash.

Each of the series of contracts sold by Fidelity embodied provisions for the creation and maintenance of a reserve fund. All of the contracts provided that the reserve fund maintained by the company should be invested in approved securities and deposited in trust as required by the laws of West Virginia. Securities purchased with the moneys paid by the contract holders were deposited with the Treasurer of West Virginia and officials of other states in compliance with their respective laws, but no effective effort was made to designate the source of the funds with which securities were purchased so as to identify the latter as belonging to the reserve of any series, nor did the state authorities make any such allocation. The securities on deposit with the states were at all times treated by the debtor, and state authorities, as securing all obligations to contract holders in the state where each deposit was made, and reports by the company to the states respecting total liabilities failed to show such liabilities by funds or series. There were certificate holders in all forty-eight states, the District of Columbia, and foreign countries.

December 14, 1938, the Securities and Exchange Commission sought an injunction in a federal court, alleging the Company was engaged in acts and practices violative of the fraud provisions of § 17(a) of the Securities Act of 1933.[9] This suit resulted in an

[8] The security afforded by these laws was stressed by sales agents and was effective in the procurement of contracts.

[9] Act of May 27, 1933, c. 38, Tit. I, § 17, 48 Stat. 84, 15 U. S. C. § 77 q.

injunction and was followed by another for appointment of a receiver in a federal court in West Virginia, which was dismissed.[10]

Prior to 1938 the debtor had made efforts to obtain fresh capital to be used in reorganizing its business. After 1938 the effort was continuous, but no capital was forthcoming.

Despite enormous sales[11] the company could not attain a solvent position. Moreover, the publicity ensuing the two suits resulted in the surrender of many contracts, the temporary suspension of the sale of new certificates, and a serious diminution of sales when activity was resumed.[12]

Pursuant to the Public Utility Holding Company Act of 1935,[13] the Securities and Exchange Commission conducted an investigation and reported its findings respecting Fidelity's business and other matters to Congress on March 13, 1940. As a result the Investment Company Act of August 22, 1940,[14] was adopted. Fidelity's officers and directors realized that the company could not meet the statutory requirements and survive. They, therefore, cast about for some other business to which the corporate resources might be devoted. They hit upon life insurance.

Accordingly, on December 31, 1940, the debtor amended its charter. The amendment changed its name to Fidelity Assurance Association, eliminated the existing corporate powers and purposes, and adopted as the corporate purpose "to issue insurance upon the lives of persons and every insurance appertaining thereto and connected therewith, and to grant, purchase, and dispose of annuities". In January 1941, by charter amendment, the authorized capital stock was altered in order to qualify the company to transact a life insurance business in West Virginia and elsewhere. The Company also registered under § 8a of the Investment Company Act, *supra*, so that it might continue to service outstanding contracts. The Insurance Commissioner of West Virginia issued a license for the conduct of an insurance business but with the understanding that no such business should be written until the company's affairs had been put into satisfactory order. Notwithstanding this arrangement, the company, by written negotiations,

[10] McCammon v. Fidelity Investment Association, 27 F. Supp. 117, affirmed Hutchinson v. Fidelity Investment Ass'n., 106 F. 2d 431.

[11] The gross business written in 1938 was $52,000,000.

[12] Sales in 1940 were $12,000,000.

[13] Act of August 26, 1935, c. 687, Tit. I, § 80, 49 Stat. 837, 15 U. S. C. § 79z-4.

[14] c. 686, 54 Stat. 789, 15 U. S. C. § 80a-1 *et seq.*

procured some 9800 of its certificate holders to accept an amendment of their outstanding certificates providing an insurance obligation on the part of the company.

At the instance of the Insurance Commissioner, the Attorney General of West Virginia, on April 11, 1941, instituted proceedings for the appointment of a receiver in the Circuit Court of Kanawha County. The company entered an appearance but interposed no answer or objection. The court appointed receivers who took over the cash and undeposited securities but did not essay to obtain possession of the assets on deposit with the Treasurer of West Virginia or with officials of other states. The authorities of the various states were notified of the pendency of this suit. Thereafter proceedings were instituted or steps taken by state officers, pursuant to state law, for the liquidation of the company's obligations to local certificate holders in Wisconsin, Iowa, Ohio, Illinois, Tennessee, Missouri, Indiana, Kentucky, Maryland, and Pennsylvania.

The respondents, other than Securities and Exchange Commission, contended below, and urge here, that the petition should be dismissed since (1) the debtor is an insurance company exempted from the provisions of the Bankruptcy Act, (2) the petition was not filed in good faith. The debtor, the trustee appointed under Chapter X, and the Commission, successfully opposed these contentions in the District Court. The Circuit Court of Appeals held with the respondents on both grounds. We find it unnecessary to consider or decide whether, at the date of filing, the debtor was an insurance company within the meaning of the Act, for we think the Circuit Court of Appeals was right in holding the petition not filed in good faith as the phrase is defined in § 146 (3) and (4).

Section 144[15] requires that if the judge is not "satisfied" that the petition "has been filed in good faith" he shall dismiss it. The relevant portions of § 146[16] are that "a petition shall be deemed not to be filed in good faith if . . . . (3) it is unreasonable to expect that a plan of reorganization can be effected; or (4) a prior proceeding is pending in any court and it appears that the interests of creditors and stockholders would be best subserved in such prior proceeding."

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[15] 11 U. S. C. § 544.
[16] 11 U. S. C. § 546.

As the court below has said, in applying the statutory test the situation should be viewed realistically. If this be done, we think the rejection by the court below of the claim of the debtor and its trustee that it can be reorganized as a going concern must be affirmed. In appraising the soundness of this claim, certain facts additional to those already noticed must be kept in mind. On April 10, 1941, there were 87,999 contracts outstanding for a face amount of $181,948,026.70. At that time liabilities exceeded assets, on the company's showing, by $2,500,000. The business written in 1940 had shrunk to 23% of that written in 1938. The Company had been losing money at the rate of $250,000 per annum. Its sale of investment certificates had ceased December 30, 1940, and, even if it had been possible to resume this activity in compliance with the requirements of the Investment Company Act, the reestablishment of the sales force would have cost $500,000.

In the light of all relevant facts, it seems clear that Fidelity cannot be reorganized for the purpose of conducting its old business of selling investment certificates. Conviction that this was so led its managers to attempt to alter its corporate purposes to those of a life insurance company. The District Judge said: "It is true that the broad picture developed by the testimony at the hearing does not present a very favorable view with respect to the rehabilitation and continued operation of the debtor as a face amount certificate company." And he added: "It is extremely doubtful whether, in view of unsettled economic conditions and the critical international situation, the Fidelity plan would any longer appeal to a large public; but it is not impossible; and it is not the duty of the court to decide for the public that investors will not or should not buy these contracts in the future."

There is no prospect that the debtor can be reorganized as an insurance company and the District Judge did not find that it could.

The petitioners say: "Upon this record, can it be said that it is unreasonable to expect that some insurance or investment company can be found to take over or buy the assets of Fidelity under a contract for the benefit of the Fidelity contract holders, to issue them investment certificates or insurance policies, of one or more kinds of greater value than the dividends to such contract holders through the liquidation of Fidelity would buy?"

The court below properly concluded that "the possibility that thousands of contract holders could be persuaded to modify their contracts and scale down their claims[17] to enable the company to go on is so remote as to exist only in the imagination."

Petitioners and Securities and Exchange Commission urge, however, that Chapter X may be employed to accomplish a slow and orderly liquidation which they say is imperative in the interest of all creditors. The District Court so held.

It must be remembered that Fidelity is admittedly insolvent and no one suggests there is any equity in its stock; that there is one greatly preponderant class of creditors,—certificate holders—all having security for their claims on one or more deposits with state authorities, and all having unsecured claims against the unpledged assets of the debtor. The necessity for decision as to the relative rights of these classes in pledged assets may present difficult questions of distribution, but has little, if any, bearing upon the method of turning the debtor's assets into money.

The deposited securities are generally readily marketable at favorable prices. They are scattered through fifteen states in hands of public officials whose duty it is to liquidate them on terms most favorable to those for whose protection they stand pledged. The suggestion that these quasi-trustees will force the securities on the market without regard to its ability to absorb them, to the destruction of their beneficiaries' security, is inadmissible and, in addition, is contrary to what occurred after the institution of the West Virginia receivership. There is no foundation for the position that the so-called reorganization should take the form of the creation of a new corporation to which all these securities would be transferred for conversion into cash, particularly as the advocates of such a project admit that the application of the security afforded classes of certificate holders according to state law cannot be avoided in any distribution of assets.

It is urged that a plan of liquidation may constitute a reorganization under Chapter X, and decisions are cited to that point,[18] but an examination of them will demonstrate that in none save where the corporate purpose of the debtor was, in effect, holding and liquidating securities was the plan such as is proposed here.

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17 The claims average less than $273 each.

18 In re Central Funding Corp., 75 F. 2d 256; In re Mortgage Securities Corp., 75 F. 2d 261; Continental Ins. Co. v. Louisiana Oil Ref. Corp., 89 F. 2d 333; R. L. Witters Associates v. Ebsary Gypsum Co., 93 F. 2d 746; In re Porto Rican American Tobacco Co., 112 F. 2d 655.

Under the facts of this case, the suggested plan is but an alternative for ordinary bankruptcy without any readjustment of the rights of creditors and stockholders *inter se*, and this fact serves to distinguish the remaining cases on which reliance is placed.

We conclude that, in this aspect, good faith, in the statutory sense, is lacking since no such reorganization as the statute was intended to accomplish is reasonably to be expected.

In the second place, we hold that the interests of creditors would be best subserved in the pending prior proceedings in West Virginia and other states. The court below was of this opinion for these reasons: It appears unlikely that there will be any surplus after payment of local claimants in any state other than West Virginia; state law must govern the distribution of the respective deposits; creditors can as readily present claims against the surplus of the West Virginia deposit in the West Virginia court as in the federal court in this proceeding.

The Securities and Exchange Commission insists that the Chapter X proceeding is more advantageous as affording opportunity for impartial investigation of wrongdoing by company officers, and the solution of problems of marshalling and distribution. If, as the court below held, nothing is to be accomplished but the liquidation of Fidelity, it is difficult to see why that process and consequent distribution of the proceeds should be held up by the search for causes of action against officers and directors. Nor is any convincing showing made that such investigation cannot, or will not, be made and availed of by the state court receivers. Moreover, if Fidelity is not an insurance company, it could have been put into ordinary bankruptcy, orderly liquidation accomplished, and impartial investigation made by a trustee elected by the creditors.

There are no true problems of marshalling presented. Creditors in the various states will unquestionably go first against the local deposits. They may, or may not, be paid in full from those funds. They will have claims against the surplus of the West Virginia fund for any deficiency. On the other hand, a surplus in a state fund after satisfaction of local creditors, will be added to the surplus fund in West Virginia for the benefit of all having claims against it. Rights against local deposits will be adjudicated by the courts of the states, near the homes of the beneficiaries and at a minimum of inconvenience, delay, and expense.

The advantages of bringing all these funds to the District Court for administration in conformity to diverse state law, and compelling claimants to come there to assert their rights, are not apparent.

It is said, however, that Fidelity agreed to segregate the reserve fund of each series, and that the holders of certificates in any series are entitled to have the securities purchased for the reserve of that series traced and set apart for their benefit, and that this can be done only in the present proceeding by bringing all the funds under a single administration.

Without reciting the facts in detail, it is enough to say that, while the different reserve funds were separately set up on the books of the company, they were, for the greater part of the period in question, kept in a single bank account and the securities purchased for the various reserve funds were not earmarked as such. Moreover, for the most part, securities deposited with state authorities were not, at the time of the deposit, designated as belonging to the reserve fund for any series of contracts. In some instances designations of them were made subsequent to their deposit. In addition, it is to be noted that under the law of West Virginia and that of other states having deposits, the securities deposited are made a common fund for the protection of all outstanding contracts, and the certificate holders were advised by the company in its literature that it proposed to deposit reserve fund securities in accordance with the law of the states. The situation discloses so many difficulties of law and fact as to render segregation for purposes of distribution of the avails of the securities improbable. And the smallness of the average amount due certificate holders indicates that the expense of the effort, if successful, would in the end prove more detrimental to a claimant than foregoing the trifling advantage of a reallocation of securities to the respective reserve funds.

It was suggested at the bar that, even if liquidation is all that can be hoped, this would be better managed by a single bankruptcy court than in several separate proceedings. The difficulty with the suggestion is that Congress did not intend resort to Chapter X to be had for the mere purpose of liquidation. The scheme of the chapter precludes any such conclusion. The mandate of § 144 is clear that unless the judge is satisfied the petition was filed in good faith he must dismiss it. Under the predecessor of Chapter

X,—§ 77 B of the Bankruptcy Act—the district judge was given authority, by subsection (c)(8),[19] under certain circumstances, to "direct the estate to be liquidated, or direct the trustees to liquidate the estate . . . ." In Chapter X, on the other hand, § 236(2)[20] provides that if no plan is approved or accepted, or if it is not consummated, the judge may, after hearing all persons in interest, adjudge the debtor a bankrupt or dismiss the proceeding as he may decide is in the interest of creditors and stockholders. Thus the statute does not contemplate a liquidation in a Chapter X proceeding but a liquidation in ordinary bankruptcy or a dismissal outright.

If the liquidation of Fidelity's affairs in bankruptcy had been proposed at the start, the petition in bankruptcy could not have been filed in the District Court for the Southern District of West Virginia in which this proceeding is pending. A Chapter X proceeding may, under § 128,[21] be initiated either at the principal place of business of the corporation or where it has its principal assets. The present proceeding was initiated in the Southern District on the ground that the principal assets of the company are located at Charleston in that district in the possession of the State Treasurer. Under § 2 of the Bankruptcy Act,[22] an ordinary bankruptcy may be initiated only at the corporation's principal place of business, which is Wheeling in the Northern District of West Virginia.

Congress did not intend a Chapter X case to be turned into a liquidation proceeding at the outset, but intended the litigation to become a straight bankruptcy only after the failure to consummate a plan, and meant to limit the parties to their remedy in ordinary bankruptcy in all other cases. It would, therefore, be a perversion of the Congressional intent to treat the present as a liquidation proceeding, since the rights of persons having liens or security pledged for their claims differ widely in the two sorts of bankruptcy.

The judgment is affirmed.

Mr. Justice DOUGLAS and Mr. Justice RUTLEDGE took no part in the consideration or decision of this case.

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19 11 U. S. C. § 207(c)(8).
20 11 U. S. C. § 636(2).
21 11 U. S. C. § 528.
22 11 U. S. C. § 11.